S. Hrg. 98-499

1983–84 MISCELLANEOUS TAX BILLS—IV
S. 108, S. 1464, S. 1549, S. 1579, AND S. 1600

HEARING

BEFORE THE

SUBCOMMITTEE ON
TAXATION AND DEBT MANAGEMENT

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

FIRST SESSION

ON

S. 108, S. 1464, S. 1549, S. 1579, and S. 1600

AUGUST 1, 1983

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1983-84 Miscellaneous Tax Bills—IV

MONDAY, AUGUST 1, 1983

U.S. SENATE,
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to notice, at 9:32 a.m. in room SD-215, Dirksen Senate Office Building, Hon. William L. Armstrong (chairman) presiding.

Present: Senators Armstrong, Grassley, Long and Matsunaga.

[The press release announcing the hearing, the text of bills S. 108, S. 1464, S. 1549, S. 1579 and S. 1600, the Joint Committee on Taxation's description and the prepared written statement of Senator Armstrong follow:]

[Press Release No. 83-160]

FINANCE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT SETS HEARING ON FIVE MISCELLANEOUS TAX BILLS

Senator Bob Packwood, Chairman of the Subcommittee on Taxation and Debt Management, announced today that a hearing will be held on Monday, August 1, 1983, on five miscellaneous tax bills.

The hearing will begin at 9:30 a.m., with an afternoon session beginning at 2:00 p.m., in Room SD-215 of the Dirksen Senate Office Building.

The following legislative proposals will be considered:

S. 1600.—Introduced by Senator Armstrong. S. 1600 would adjust for inflation the tax basis of certain corporate stock and real property for purposes of determining capital gains.

S. 1579.—Introduced by Senator Armstrong. S. 1579 would make the mileage allowance for tax deductions for the use of a private automobile in providing services to charities equal to the mileage allowance for tax deductions for business use of an automobile.

S. 108.—Introduced by Senator Grassley for himself and others. S. 108 would increase tax incentives for corporate charitable contributions of vocational edcuation equipment and provide new tax incentives for other corporate assistance to vocational education programs.

S. 1464.—Introduced by Senators Armstrong and Hart. S. 1464 would amend the Tax Reform Act of 1969 with respect to application of the private foundation excess business holding provisions to the El Pomar Foundation of Colorado Springs, Colorado.

S. 1549.—Introduced by Senator Armstrong for himself and others. S. 1549 would permit individual retirement accounts, qualified retirement trusts, and certain educational organizations to invest in working interests in oil and gas properties without incurring unrelated business taxable income.

II

98TH CONGRESS
1ST SESSION

S. 108

7

To amend the Internal Revenue Code of 1954 to encourage contributions of equipment to postsecondary vocational education programs and to allow a credit to employers for vocational education courses taught by an employee without compensation and for temporary employment of full-time vocational educational instructors.

IN THE SENATE OF THE UNITED STATES

JANUARY 26 (legislative day, JANUARY 25), 1983

Mr. GRASSLEY introduced the following bill; which was read twice and referred to the Committee on Finance

---

A BILL

To amend the Internal Revenue Code of 1954 to encourage contributions of equipment to postsecondary vocational education programs and to allow a credit to employers for vocational education courses taught by an employee without compensation and for temporary employment of full-time vocational educational instructors.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. CONTRIBUTIONS OF PROPERTY USED IN VOCATIONAL EDUCATION PROGRAMS.

(a) IN GENERAL.—Subsection (e) of section 170 of the Internal Revenue Code of 1954 (relating to certain contributions of ordinary income and capital gain property) is amended by adding at the end thereof the following new paragraph:

"(5) SPECIAL RULE FOR CONTRIBUTIONS OF PROPERTY USED IN CERTAIN VOCATIONAL EDUCATION PROGRAMS.—

"(A) LIMIT OR REDUCTION.—In the case of a postsecondary vocational education contribution, the reduction under paragraph (1)(A) shall be no greater than the amount determined under paragraph (3)(B).

"(B) POSTSECONDARY VOCATIONAL EDUCATION CONTRIBUTION.—For purposes of this paragraph, the term 'postsecondary vocational education contribution' means a charitable contribution of tangible personal property but only if—

"(i) such contribution is to a public community college or public technical institute (within the meaning of section 742(b) of the Higher Education Act of 1965 (20 U.S.C. 1132e–1)) or any other institution of higher education (within the meaning of section 1201(a) of such Act (20 U.S.C. 1141)),

"(ii) substantially all of the use of such property by the donee is for training students enrolled in a postsecondary vocational education program offered by the donee,

"(iii) such property is not transferred by the donee in exchange for money, other property, or services, and

"(iv) the taxpayer receives from the donee a written statement representing that the donee's use and disposition of such property will be in accordance with the provisions of clauses (ii) and (iii).

"(C) POSTSECONDARY VOCATIONAL EDUCATION PROGRAM.—For purposes of this paragraph, the term 'postsecondary vocational education program' means an organized education program which—

"(i) is a 2-year program in engineering, mathematics, or the physical or biological sciences, designed to prepare a student to work as a technician or at the semiprofessional level in engineering, scientific, or other technological fields requiring the understanding and application of basic engineering, scientific, or mathematical principles of knowledge, or "(ii) is directly related to the preparation of individuals for paid or unpaid employment or for a career which does not require a baccalaureate or advanced degree.".

(b) Effective Date.—The amendment made by this section shall apply to contributions made after December 31, 1982.

SEC. 2. POSTSECONDARY VOCATIONAL EDUCATION INSTRUCTION CREDIT.

(a) In General.—Subpart A of part IV of subchapter A of chapter 1 of the Internal Revenue Code of 1954 (relating to credits allowable against tax) is amended by inserting after section 44G the following new section:

"SEC. 44H. VOCATIONAL EDUCATION INSTRUCTION CREDIT.

"(a) In General.—There shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to the sum of—

"(1) the product of—

"(A) $100, multiplied by

"(B) the number of postsecondary vocational education courses taught by qualified teaching employees of the taxpayer during the taxable year, plus

"(2) the product of—

"(A) $100, multiplied by

"(B) the number of qualified vocational education instructors who were employed by the taxpayer during the taxable year.

"(b) LIMITATIONS.—

"(1) LIMITATION ON THE NUMBER OF COURSES TAUGHT PER EMPLOYEE.—No more than 5 postsecondary vocational education courses taught by the same qualified teaching employee may be taken into account under subsection (a)(1)(B).

"(2) LIMITATION BASED ON AMOUNT OF TAX.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the credit allowed by subsection (a) for any taxable year shall not exceed the amount of the tax imposed by this chapter for the taxable year reduced by the sum of the credits allowable for the taxable year under a section of this part having a lower number or letter designation than this section, other than the credits allowable by sections 31, 39, and 43. For purposes of the preceding sentence, the term 'tax imposed by this chapter' shall not include any tax treated as not imposed by this chapter under the last sentence of section 53(a).

"(B) SPECIAL RULE FOR PASSTHROUGH OF CREDIT.—In the case of an individual who—

"(i) owns an interest in an unincorporated trade or business,

"(ii) is a partner in a partnership,

"(iii) is a beneficiary of an estate or trust, or

"(iv) is a shareholder in an electing small business corporation (within the meaning of section 1371(b)),

the credit allowed by subsection (a) for any taxable year shall not exceed the lesser of the amount determined under subparagraph (A) for the taxable year or an amount (separately computed with respect to such person's interest in such trade or business or entity) equal to the amount of tax attributable to that portion of a person's taxable income which is allocable or apportionable to the person's interest in such trade, business, or entity.

(c) Definitions and Special Rules.—For purposes of this section—

"(1) Postsecondary vocational education courses.—The term 'postsecondary vocational education course' means any course of instruction which—

"(A) is offered by an institution of higher education as part of an organized education program that—

"(i) is a 2-year program in engineering, mathematics, or the physical or biological sciences, designed to prepare a student to work as a technician or at the semiprofessional level in engineering, scientific, or other technological fields requiring the understanding and application of basic engineering, scientific, or mathematical principles of knowledge, or

"(ii) is directly related to the preparation of individuals for paid or unpaid employment or for a career which does not require a baccalaureate or advanced degree,

"(B) consists of a period of instruction which is at least equivalent to a course of instruction that provides 3 hours of instruction per week during an academic semester, and

"(C) has been completed before the close of the taxable year.

"(2) QUALIFIED VOCATIONAL EDUCATION INSTRUCTOR.—The term 'qualified vocational education instructor' means an individual who—

"(A) was employed by the taxpayer on a full-time basis for at least 3 months but not more than 12 months during the 2-year period ending at the close of the taxable year,

"(B) prior to such employment, taught postsecondary vocational education courses on a full-time basis at an institution of higher education,

"(C) is teaching such courses on a full-time basis at an institution of higher education at the close of such taxable year, and

"(D) is not employed by the taxpayer at the close of the taxable year.

"(3) QUALIFIED TEACHING EMPLOYEE.—The term 'qualified teaching employee' means an individual who—

"(A) taught at least one postsecondary vocational education course on a part-time basis at an institution of higher education during the taxable year,

"(B) is a full-time employee of the taxpayer for the entire taxable year,

"(C) does not receive any compensation from such institution of higher education, and

"(D) was not a qualified vocational education instructor at any time during the taxable year.

"(4) INSTITUTION OF HIGHER EDUCATION.—The term 'institution of higher education' has the meaning given such term in section 1201(a) of the Higher Education Act of 1965.

"(5) ALLOCATION.—

"(A) CONTROLLED GROUP OF CORPORATIONS.—In determining the amount of the credit under this section—

"(i) all members of the same controlled group of corporations shall be treated as a single taxpayer, and

"(ii) the credit (if any) allowable by this section to each such member with respect to any qualified teaching employee or qualified vocational education instructor shall be in proportion to the member's share of the wages paid for the taxable year to such qualified teaching employee or qualified vocational education instructor.

"(B) COMMON CONTROL.—Under regulations prescribed by the Secretary, in determining the amount of credit under this section—

"(i) all trades or businesses (whether or not incorporated) which are under common control shall be treated as a single taxpayer, and "(ii) the credit (if any) allowable by this section to each such trade or business with respect to any qualified teaching employee or qualified vocational edication instructor shall be in proportion to such trade or business' share of the wages paid for the taxable year to such qualified teaching employee or qualified vocational education instructor with respect to whom the credit is allowable.

The regulations prescribed under this subparagraph shall be based on principles similar to the principles which apply in the case of subparagraph (A).

"(C) PASSTHROUGH IN THE CASE OF SUBCHAPTER S CORPORATIONS, ETC.—Under regulations prescribed by the Secretary, rules similar to the rules of subsections (d) and (e) of section 52 shall apply.

"(D) ALLOCATION IN THE CASE OF PARTNERSHIPS.—In the case of partnerships, the credit shall be allocated among partners under regulations prescribed by the Secretary.

"(6) CONTROLLED GROUP OF CORPORATIONS.—The term 'controlled group of corporations' has the same meaning given to such term by section 1563(a), except that —

"(A) 'more that 50 percent' shall be substituted for 'at least 80 percent' each place it appears in section 1563(a)(1), and

"(B) the determination shall be made without regard to subsections (a)(4) and (e)(3)(C) of section 1563.".

"(7) DOUBLE BENEFIT.—Any credit allowable under this section for the taxable year with respect to any employee of the taxpayer shall be in addition to any deduction under this chapter which is allowable to the taxpayer for such taxable year with respect to compensation paid to such employee.".

(b) CONFORMING AMENDMENTS.—

(1) The table of sections for subpart A of part IV of subchapter A of chapter 1 of such Code is amended by inserting after the item relating to section 44G the following new item:

"Sec. 44H. Vocational education instruction credit.".

(2) Section 6096(b) of such Code (relating to designation of income tax payments to Presidential Election Campaign Fund) is amended by striking out "and 44G" and inserting in lieu thereof "44G, and 44H".

SEC. 3. EFFECTIVE DATE.

The amendments made by this Act shall apply to taxable years beginning after December 31, 1982.

○

II

98TH CONGRESS
1ST SESSION

S. 1464

To amend the Tax Reform Act of 1969 with respect to the application of the excess business holding provisions to private foundations.

IN THE SENATE OF THE UNITED STATES

JUNE 14 (legislative day, JUNE 13), 1983

Mr. ARMSTRONG (for himself and Mr. HART) introduced the following bill; which was read twice and referred to the Committee on Finance

---

A BILL

To amend the Tax Reform Act of 1969 with respect to the application of the excess business holding provisions to private foundations.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 101(l)(4) of the Tax Reform Act of 1969 is amended by adding at the end thereof the following new subparagraph:

"(D)(i) The divestiture requirements of section 4943 of the Internal Revenue Code of 1954 shall not apply to the stock of a corporation held by any private foundation if the foundation and the corporation meet the following conditions:

"(I) On May 26, 1969, the private foundation owned 100 percent of the voting stock in the corporation and substantially all of the operating assets of the corporation were used in operating a hotel business enterprise.

"(II) The stock described in subclause (I) was acquired by the foundation solely by gift, devise, or bequest before December 31, 1966.

"(III) Neither the donor of such stock nor any member of his family (within the meaning of section 4946(d) of such Code) is a manager of such foundation (as defined in section 4946(b) of such Code) on or after December 31, 1956.

"(IV) On May 26, 1969, and at all times thereafter—

"(aa) the hotel business enterprise described in subclause (I) is of substantially the same character as the enterprise which was conducted by the corporation on the date of the last gift, devise, or bequest of such stock of such corporation by any donor or member of his family, and

"(bb) substantially all of the operating assets of the corporation are used in operating such hotel business enterprise.

For purposes of this clause, a hotel business enterprise owned by a private foundation through a holding company all the voting stock of which is owned directly by the foundation on the dates designated by this clause shall be treated as being owned directly by the foundation for these purposes. This clause shall apply to the private foundation only if the foundation does not acquire any stock or other interest in any business enterprise on or after May 26, 1969, which would otherwise constitute excess business holdings under section 4943 of such Code.

○

II

98th CONGRESS
1st Session

S. 1549

To amend the Internal Revenue Code of 1954 to permit individual retirement accounts, qualified retirement trusts and certain educational organizations to invest in working interests in oil and gas properties without incurring unrelated business taxable income.

IN THE SENATE OF THE UNITED STATES

June 27, 1983

Mr. Armstrong (for himself and Mr. Long, Mr. Durenberger, Mr. Wallop, Mr. Grassley, Mr. Symms, Mr. Bentsen, Mr. Baucus, Mr. Boren, and Mr. Pryor) introduced the following bill; which was read twice and referred to the Committee on Finance

---

A BILL

To amend the Internal Revenue Code of 1954 to permit individual retirement accounts, qualified retirement trusts and certain educational organizations to invest in working interests in oil and gas properties without incurring unrelated business taxable income.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) subsection (b) of section 512 of the Internal Revenue Code of 1954 (relating to modifications to unrelated business taxable income) is amended by inserting after paragraph (15) the following new paragraph:

"(16)(A) In the case of a trust which constitutes a qualified trust under section 401 or which is described in section 408(a) or of an organization described in section 170(b)(1)(A) (ii) or (iv), there shall be excluded all income from a working interest in a domestic oil or gas well, and all deductions and credits directly connected with such income or interest, if such income is allocated to such trust or organization as a limited partner by a limited partnership which at no time during the partnership taxable year in which such allocation is made—

"(i) allocated to the limited partners a lesser share of any item of deduction, loss or credit than their share of income or gain,

"(ii) allocated among the limited partners shares of any item of deduction, loss or credit which differed from the ratio in which they shared income or gain,

"(iii) allocated cash distributions to partners in a different manner than the allocation of income or gain, and

"(iv) had a general partner related to such trust or organization.

"(B) Subparagraph (A) shall not apply in any case, as determined under regulations prescribed by the

Secretary, in which multitier partnerships or other arrangements are used for the principal purpose of avoiding the conditions of such subparagraph. Clauses (i), (ii) and (iii) of subparagraph (A) shall not apply to allocations made in accordance with section 704(c)(2) (relating to property contributed to the partnership) on a nondiscriminatory basis as between exempt and nonexempt limited partners.

"(C) For purposes of subparagraph (A)—

"(i) a trust is related to any person that bears the relationship to it described in section 514(c)(9)(B)(iv) (I) and (II); and

"(ii) an organization is related to any person described in section 4946(a)(1)(A) through (G); and

"(iii) a trust or organization is related to—

"(I) any corporation in which it (directly or together with any persons described in clause (i) or (ii)) holds 35 percent or more of the combined voting power of all classes of stock entitled to vote or the total value of shares of all classes of stock of such corporation,

"(II) any partnership in which it (directly or together with any persons described in clause (i) or (ii)) holds 35 percent or more of the capital interest or profits interest or

"(III) a trust or estate in which it (directly or together with any persons described in clause (i) or (ii)) holds 35 percent or more of the beneficial interest.

"For purposes of this subparagraph, in applying section 514(c)(9)(B)(iv) (I) and (II), '35 percent' shall be substituted for '50 percent' in section 4975(e)(2) (E) and (G), and in applying section 4946(a)(1) (A) through (G), 'organization described in section 170(b)(1)(A) (ii) or (iv)' shall be substituted for 'foundation' or 'private foundation' in section 4946 and section 507(d)(2). In applying this subparagraph, a trust or organization which is a limited partner in a partnership shall be treated as owning an interest in the general partner held by any other such trust or organization (or any person related thereto) which is a partner in such partnership.".

(b) Subsection (c) of section 514 of the Internal Revenue Code of 1954 (relating to unrelated debt-financed income) is amended by inserting after paragraph (9) the following new paragraph:

"(10) CERTAIN OIL AND GAS INTERESTS.—For purposes of this section—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the term 'acquisition indebtedness' with respect to a trust which constitutes a qualified trust under section 401 or which is described in section 408(a) or an organization described in section 170(b)(1)(A) (ii) or (iv) does not include indebtedness incurred by a limited partnership described in section 512(b)(16) in acquiring, developing or operating a working interest in a domestic oil or gas well.

"(B) EXCEPTIONS.—The provisions of subparagraph (A) shall not apply with respect to a trust or organization in any case in which—

"(i) the acquisition price of such working interest is not a fixed amount determined as of the date of acquisition;

"(ii) the amount of any such indebtedness or any other amount payable with respect to such indebtedness or the time for making any payment of any such amount, is dependent, in whole or in part, upon any revenue, income, or profits derived by or from such limited partnership;

"(iii) such working interests are at any time after their acquisition leased by the limited partnership to the person selling such properties to the limited partnership or to any person who bears a relationship described in section 267(b) to such person;

"(iv) such working interests are acquired from, or are at any time after the acquisition leased by the limited partnership to, any person who bears a relationship described in section 512(b)(16)(C) to such trust or organization; or

"(v) any person described in clause (iii) or (iv) provides such limited partnership, trust, or organization with nonrecourse financing in connection with such transaction and such debt—

"(I) is subordinate to any other indebtedness on such property, or

"(II) bears interest at a rate which is significantly less than the rate available from any person not described in clause (iii) or (iv) at the time such indebtedness is incurred.

"(C) SPECIAL RULE FOR CERTAIN TRANSFERS.—The provisions of clauses (iii), (iv) and (v) of subparagraph (B) shall not apply to any acquisition, lease, farmout or other transfer of working interests to a person related to the general partner provided the terms of such transfer are consistent with the terms of similar transfers in the geographic area.".

(c) The amendments made by this subsection shall apply to partnership taxable years beginning after December 31, 1982.

○

II

98th CONGRESS
1st Session

S. 1579

To amend the Internal Revenue Code of 1954 to provide that the standard mileage rate for use of a passenger automobile which may be used in computing the charitable contribution deduction shall be the same as the standard mileage rate which may be used in computing the business expense deduction.

IN THE SENATE OF THE UNITED STATES

June 29 (legislative day, June 27), 1983

Mr. Armstrong introduced the following bill; which was read twice and referred to the Committee on Finance

---

A BILL

To amend the Internal Revenue Code of 1954 to provide that the standard mileage rate for use of a passenger automobile which may be used in computing the charitable contribution deduction shall be the same as the standard mileage rate which may be used in computing the business expense deduction.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) section 170 of the Internal Revenue Code of 1954 (relating to charitable, etc., contributions and gifts) is amended by redesignating subsections (h) and (i) as subsections (i) and (j), respectively, and by inserting after subsection (g) the following new subsection:

"(h) STANDARD MILEAGE RATE FOR USE OF PASSENGER AUTOMOBILE.—If the Secretary prescribes by regulation a standard mileage rate which may be used to compute for the taxable year the deduction under section 162 for use of a passenger automobile, such standard mileage rate may be used to compute for such year the deduction under this section for use of a passenger automobile.".

(b) The amendments made by subsection (a) shall apply to taxable years beginning after December 31, 1982.

○

II

98TH CONGRESS
1ST SESSION

S. 1600

To provide for the indexing of the basis of certain capital assets.

IN THE SENATE OF THE UNITED STATES

JULY 12 (legislative day, JULY 11), 1983

Mr. ARMSTRONG introduced the following bill; which was read twice and referred to the Committee on Finance

---

A BILL

To provide for the indexing of the basis of certain capital assets.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That—

(a) IN GENERAL.—Part II of subchapter O of chapter 1 (relating to basis rules of general application) is amended by inserting after section 1019 the following new section:

"SEC. 1020. INDEXING OF CERTAIN ASSETS FOR PURPOSES OF DETERMINING GAIN OR LOSS.

"(a) GENERAL RULE.—

"(1) INDEXED BASIS SUBSTITUTES FOR ADJUSTED BASIS.—Except as provided in paragraph (2), if an indexed asset which has been held for more than 1 year is sold or otherwise disposed of, for purposes of this title the indexed basis of the asset shall be substituted for its adjusted basis.

"(2) EXCEPTION FOR DEPRECIATION, ETC.—The deduction for depreciation, depletion, and amortization shall be determined without regard to the application of paragraph (1) to the taxpayer or any other person.

"(b) INDEXED ASSET.—

"(1) IN GENERAL.—For purposes of this section, the term 'indexed asset' means—

"(A) stock in a corporation, and

"(B) real property (or any interest therein), which is a capital asset or property used in the trade or business (as defined in section 1231(r)).

"(2) CERTAIN PROPERTY EXCLUDED.—For purposes of this section, the term 'indexed asset' does not include—

"(A) CREDITOR'S INTEREST.—Any interest in property which is in the nature of a creditor's interest.

"(B) OPTIONS.—Any option or other right to acquire an interest in property.

"(C) NET LEASE PROPERTY.—In the case of a lessor, net lease property, (within the meaning of subsection (h)(1)).

"(D) CERTAIN PREFERRED STOCK.—Stock which is fixed and preferred as to dividends and does not participate in corporate growth to any significant extent.

"(E) STOCK IN CERTAIN CORPORATIONS.—Stock in—

"(i) an electing small business corporation (within the meaning of section 1371(h)),

"(ii) a personal holding company (as defined in section 542), and

"(iii) a foreign corporation.

"(3) EXCEPTION FOR STOCK IN FOREIGN CORPORATION WHICH IS REGULARLY TRACED ON NATIONAL OR REGIONAL EXCHANGE.—Clause (iii) of paragraph (2)(F) shall not apply to stock in a foreign corporation the stock of which is listed on the New York Stock Exchange, the American Stock Exchange, or any domestic regional exchange for which quotations are published on a regular basis other than—

"(A) stock of a foreign investment company (within the meaning of section 1246(b)), and

"(B) stock in a foreign corporation held by a United States person who meets the requirements of section 1248(a)(2).

"(c) INDEXED BASIS.—For purposes of this section—

"(1) INDEXED BASIS.—The indexed basis for any asset is—

"(A) the adjusted basis of the asset, multiplied by

"(B) the applicable inflation ratio.

"(2) APPLICABLE INFLATION RATIO.—The applicable inflation ratio for any asset is the percentage arrived at by dividing—

"(A) the gross national product deflator for the calendar quarter in which the disposition takes place, by

"(B) the gross national product deflator for the calendar quarter in which the asset was acquired by the taxpayer (or, if later, the calendar quarter ending December 31, 1984).

The applicable inflation ratio shall not be taken into account unless it is greater than 1. The applicable inflation ratio for any asset shall be rounded to the nearest 1/10 of 1 percent.

"(3) GROSS NATIONAL PRODUCT DEFLATOR.—The gross national product deflator for any calendar quarter is the implicit price deflator for the gross national product for such quarter (as shown in the first revision thereof.)

"(d) SPECIAL RULES.—For purposes of this section—

"(1) TREATMENT AS SEPARATE ASSET.—In the case of any asset, the following shall be treated as a separate asset:

"(A) a substantial improvement to property,

"(B) in the case of stock of a corporation, a substantial contribution to capital, and

"(C) any other portion of an asset to the extent that separate treatment of such portion is appropriate to carry out the purposes of this section.

"(2) ASSETS WHICH ARE NOT INDEXED ASSETS THROUGHOUT HOLDING PERIOD.—

"(A) IN GENERAL.—The applicable inflation ratio shall be appropriately reduced for calendar months at any time during which the asset was not an indexed asset.

"(B) CERTAIN SHORT SALES.—For purposes of applying subparagraph (A), an asset shall be treated as not an indexed asset for any short sale period during which the taxpayer or the taxpayer's spouse sells short property substantially identical to the asset. For purposes of the preceding sentence, the short sale period begins on the day after the substantially identical property is sold and ends on the closing date for the sale.

"(3) **Treatment of certain distributions.**—A distribution with respect to stock in a corporation which is not a dividend shall be treated as a disposition.

"(4) **Section cannot increase ordinary loss.**—To the extent that (but for this paragraph) this section would create or increase a net ordinary loss to which the second sentence of section 1231(a) applies or an ordinary loss to which any other provision of this title applies, such provision shall not apply. The taxpayer shall be treated as having a long-term capital loss in an amount equal to the amount of the ordinary loss to which the preceding sentence applies.

"(5) **Acquisition date where there has been prior application of subsection (a)(1) with respect to the taxpayer.**—If there has been a prior application of subsection (a)(1) to an asset while such asset was held by the taxpayer, the date of acquisition of such asset by the taxpayer shall be treated as not earlier than the date of the most recent such prior application.

"(6) **Collapsible corporations.**—The application of section 341(a) (relating to collapsible corporations) shall be determined without regard to this section.

"(e) CERTAIN CONDUIT ENTITIES.—

"(1) REGULATED INVESTMENT COMPANIES; REAL ESTATE INVESTMENT TRUSTS; COMMON TRUST FUNDS.—

"(A) IN GENERAL.—Stock in a qualified investment entity shall be an indexed asset for any calendar month in the same ratio as the fair market value of the assets held by such entity at the close of such month which are indexed assets bears to the fair market value of all assets of such entity at the close of such month.

"(B) RATIO OF 90 PERCENT OR MORE.—If the ratio for any calendar month determined under subparagraph (A) would (but for this subparagraph) be 90 percent or more, such ratio for such month shall be 100 percent.

"(C) RATIO OF 10 PERCENT OR LESS.—If the ratio for any calendar month determined under subparagraph (A) would (but for this subparagraph) be 10 percent or less, such ratio for such month shall be zero.

"(D) VALUATION OF ASSETS IN CASE OF REAL ESTATE INVESTMENT TRUSTS.—Nothing in this paragraph shall require a real estate investment trust to value its assets more frequently than once each 36 months (except where such trust ceases to exist). The ratio under subparagraph (A) for any calendar month for which there is no valuation shall be the trustee's good faith judgment as to such valuation.

"(E) QUALIFIED INVESTMENT ENTITY.—For purposes of this paragraph, the term 'qualified investment entity' means—

"(i) a regulated investment company (within the meaning of section 851),

"(ii) a real estate investment trust (within the meaning of section 856), and

"(iii) a common trust fund (within the meaning of section 584).

"(2) PARTNERSHIPS.—In the case of a partnership, the adjustment made under subsection (a) at the partnership level shall be passed through to the partners.

"(3) SUBCHAPTER S CORPORATIONS.—In the case of an electing small business corporation, the adjustment under subsection (a) at the corporate level shall be passed through to the shareholders.

"(f) DISPOSITIONS BETWEEN RELATED PERSONS.—

"(1) IN GENERAL.—This section shall not apply to any sale or other disposition of property between related persons except to the extent that the basis of such property in the hands of the transferee is a substituted basis.

"(2) Related persons defined.—For purposes of this section, the term 'related persons' means—

"(A) persons bearing a relationship set forth in section 267(b), and

"(B) persons treated as single employers under subsection (b) or (c) of section 414.

"(g) Transfers To Increase Indexing Adjustment or Depreciation Allowance.—If any person transfers cash, debt, or any other property to another person and the principal purpose of such transfer is—

"(1) to secure or increase an adjustment under subsection (a), or

"(2) to increase (by reason of an adjustment under subsection (a)) a deduction for depreciation, depletion, or amortization,

the Secretary may disallow part or all of such adjustment or increase.

"(h) Definitions.—For purposes of this section—

"(1) Net lease property defined.—The term 'net lease property' means leased real property where—

"(A) the term of the lease (taking into account options to renew) was 57 percent or more of the useful life of the property, and

"(B) for the period of the lease, the sum of the deductions with respect to such property which are allowable to the lessor solely by reason of section 162 (other than rents and reimbursed amounts with respect to such property) is 15 percent or less of the rental income produced by such property.

"(2) STOCK INCLUDES INTEREST IN COMMON TRUST FUND.—The term 'stock in a corporation' includes any interest in a common trust fund (as defined in section 584(a)).

"(i) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section.".

(b) CLERICAL AMENDMENT.—The table of sections for part II of subchapter O of such chapter 1 is amended by inserting after the item relating to section 1019 the following new item:

"Sec. 1020. Indexing of certain assets for purposes of determining gain or loss.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to sales and exchanges after December 31, 1983.

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DESCRIPTION OF TAX BILLS
(S. 1600, S. 1579, S. 108, S. 1464, and S. 1549)

Scheduled for a Hearing

before the

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

of the

COMMITTEE ON FINANCE

ON AUGUST 1, 1983

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

INTRODUCTION

The bills described in this pamphlet have been scheduled for a public hearing on August 1, 1983, by the Senate Finance Subcommittee on Taxation and Debt Management.

The five bills scheduled for the hearing, in the order listed in the press release announcing the hearing, are S. 1600 (relating to indexing the basis of certain assets), S. 1579 (relating to charitable deduction for use of passenger automobile), S. 108 (relating to tax incentives for vocational education programs), S. 1464 (relating to exemption from divestiture requirements of excess business holdings provision for the El Pomar Foundation), and S. 1549 (relating to exemption from unrelated business income tax for income from certain oil and gas property).

The first part of the pamphlet is a summary of the bills. This is followed in the second part by a more detailed description of the bills, including present law, explanation of provisions, and effective dates.

I. SUMMARY

1. S. 1600—Senator Armstrong

Indexing the Basis of Certain Assets

Under present law, the adjusted basis for determining gain or loss from the disposition of capital assets is established in fixed dollar amounts. Thus, changes in the value of the dollar resulting from inflation are not taken into account for this purpose.

The bill would provide for an inflation adjustment (i.e., indexing) to the basis of certain assets for purposes of determining gain or loss on a taxable disposition. The adjustment would be applicable to certain corporate stock and real property interests. The adjustment would apply only to inflation occurring after 1983. The inflation adjustment would not apply for purposes of determining depreciation and other cost-related deductions.

2. S. 1579—Senator Armstrong

Charitable Expense Deduction for Use of Passenger Automobile

Under present law, individual taxpayers may deduct charitable contributions up to certain limits (Code sec. 170). In determining the amount of their charitable contribution deduction, taxpayers may deduct their actual fuel expenses for a vehicle used to provide services to a charitable organization, or may use a standard rate of nine cents a mile.

Under the bill, taxpayers would be allowed to use the standard mileage rate authorized for computing the business expense deduction for business use of a passenger automobile. At present, that rate generally is 20 cents a mile for the first 15,000 miles of business use, and 11 cents a mile for each additional mile. The bill would apply to taxable years beginning after 1982.

3. S. 108—Senators Grassley, Jepsen, Durenberger, and Thurmond

Tax Incentives for Vocational Education Programs

a. Increased charitable deduction for contributions of equipment to postsecondary vocational education programs

Present law

In general, the amount of charitable deduction otherwise allowed for donated property must be reduced by the amount of any ordinary gain which the taxpayer would have realized had the property been sold at its fair market value on the date of the donation (sec. 170(e)). For example, a manufacturer that makes a charitable donation of inventory generally may deduct only its basis in the property.

However, under a special rule, corporations are allowed an augmented charitable deduction for donations of newly manufactured scientific equipment to a college or university for research use in the physical or biological sciences (sec. 170(e)(4)). The augmented deduction is generally for the sum of (1) the corporation's basis in the donated property and (2) one-half of the property's unrealized appreciation. In no event may the amount of the deduction under the special rule exceed twice the basis of the property.

Explanation of provision

Section 1 of the bill would provide an augmented charitable deduction for corporate or other taxpayers making certain donations of tangible personal property to institutions of higher education which use the property to train students enrolled in a postsecondary vocational education program.

For qualifying donations, the augmented charitable deduction allowed generally would equal the sum of the taxpayer's basis in the donated property and one-half of the property's unrealized appreciation. In no event would a deduction be allowed for any amount which exceeded twice the property's basis.

This provision of the bill would be effective for donations made after 1982.

b. Postsecondary vocational education instruction tax credit

Present law

Employers generally may deduct as an ordinary and necessary business expense a reasonable allowance for compensation paid employees (sec. 162). Thus, a manufacturer, for example, generally may deduct reasonable compensation paid to vocational education teachers who work temporarily for the manufacturer to upgrade their skills, although regularly employed by teaching institutions.

Present law also provides a targeted jobs credit to employers who hire individuals belonging to any of several defined groups (sec. 51). The targeted jobs credit is available with respect to certain vocational education students employed under cooperative education programs; it does not apply to vocational education teachers.

Explanation of provision

Section 2 of the bill would provide a nonrefundable credit with respect to (1) postsecondary vocational education courses taught by qualified teaching employees of the taxpayer and (2) vocational education instructors temporarily employed by the taxpayer.

The amount of the new credit would be $100 for each postsecondary vocational education course taught by a qualified teaching employee during the taxable year (not to exceed five courses per employee per year), plus $100 for each qualified vocational education instructor temporarily employed during the taxable year.

The bill specifies that the credit would be in addition to allowable deductions for compensation paid to employees.

This provision of the bill would be effective for taxable years beginning after 1982.

4. S. 1464—Senators Armstrong and Hart

Exemption from Divestiture Requirements of Excess Business Holdings Provision for the El Pomar Foundation

The bill would exempt the El Pomar Foundation of Colorado Springs, Colorado, from the divestiture requirements with respect to excess business holdings which apply to private foundations (sec. 4943).

5. S. 1549—Senators Armstrong, Long, Durenberger, Wallop, Grassley, Symms, Bentsen, Baucus, Boren, and Pryor

Exemption from Unrelated Business Income Tax for Income from Certain Oil and Gas Property

Under present law, most organizations which generally are exempt from Federal income taxation under Code section 501(a), including any trust that is part of a tax-qualified pension, profit-sharing, or stock bonus plan described in section 401(a), are subject to tax on any unrelated business taxable income (secs. 511-514). In addition, a tax is imposed on the unrelated trade or business income of an individual retirement account or annuity (an IRA).

Under the bill, certain exempt organizations would be permitted to invest in limited partnerships owning working interests in domestic oil and gas properties without incurring tax for unrelated business income. The organizations that would be eligible under this provision include exempt trusts forming a part of tax-qualified pension, etc., plans, IRAs, and certain tax-exempt educational organizations. The bill would apply for partnership taxable years beginning after 1982.

II. DESCRIPTION OF BILLS

1. S. 1600—Senator Armstrong

Indexing the Basis of Certain Assets

Present Law

A taxpayer generally recognizes gain from an increase in value of a capital asset, or takes into account an allowable loss from a decline in value of the asset, only on the sale, exchange, or other disposition of the asset. If the taxpayer continues to hold the asset, no appreciation in value of the asset is includible in income, and no loss is allowable for any decline in value.

Gain on disposition of a capital asset which has been held for more than one year is taxable at reduced rates. Capital assets generally include property held by the taxpayer other than property held for sale to customers and property used in the taxpayer's trade or business. In addition, gain from the disposition of property used in a trade or business, in excess of depreciation recapture, may be treated as gain from the sale of a capital asset.

For a noncorporate taxpayer, only 40 percent of net capital gains (i.e., the excess of net long-term capital gain over net short-term capital loss) is included in taxable income. These gains are therefore taxable at a maximum 20-percent rate. For corporations, an alternative tax rate of 28 percent applies to net capital gain if the tax computed using that rate is lower than the corporation's regular tax.

The reduced tax rates for capital gains are taken into account as preference items for purposes of the corporate and noncorporate minimum taxes.

Background

Effect of inflation—U.S. tax law

The Federal tax law generally does not take inflation into account in determining taxable income. For example, under U.S. tax law, the adjusted basis for determining gain or loss from a taxable disposition of property is established in fixed dollar amounts. Thus, the law does not take into account for this purpose changes in the value of the dollar resulting from inflation.

For example, a taxpayer who purchases a share of stock for $100, and sells the stock for $150 ten years later, recognizes $50 of income in the year of sale. This is the result notwithstanding that, to the extent inflation has occurred during these years, it would require more than $100 at the time of disposition to return to the taxpayer the $100 in value invested in the asset. The $50 of income recognized generally would be subject to the reduced tax rates applicable to capital gains.

For certain other purposes, U.S. tax law does take inflation into account. Under the Economic Recovery Tax Act of 1981, income tax brackets for individuals, as well as the zero bracket and personal exemption amounts, will be adjusted each year for inflation beginning in 1985 (Code sec. 1(f)). The adjustment for each year will be based upon the percentage by which the consumer price index (CPI) for the preceding year exceeds the CPI for 1983. This provision is designed to prevent taxpayers from being pushed into higher percentage tax brackets by inflation.

In addition, the base price for determining the windfall profit tax on domestic crude oil is adjusted for inflation as measured by the implicit price deflator for the gross national product (sec. 4989(b)). Further, beginning in 1986, the limits on contributions to, and benefits from, a qualified pension plan will be adjusted for post-1984 cost-of-living increases, as determined under the formula then in effect for determining social security benefit levels (sec. 415(d)(2)).[1]

Effect of inflation—foreign tax laws

United Kingdom

In 1982, the United Kingdom enacted an indexation allowance for assets held for one year or longer.[2] The allowance applies only for inflation occurring after 1982. The allowance is based on the percentage by which the retail price index for the month in which an asset is disposed of exceeds the index at a time one year after the related expenditure was made. The amount of any capital gain is reduced by the indexation allowance for the applicable holding period. Where the allowance exceeds the adjusted gain, no gain or loss is recognized. The allowance is not applicable to capital losses.

Canada

The Canadian Government, in its budget of April 1983, proposed an elective indexation program for Canadian securities, known as the Indexed Security Investment Plan (ISIP).[3] The plan would be limited to publicly listed common stock of Canadian corporations.

Under the Canadian plan, stock purchased under an ISIP would be adjusted each month according to the percentage increase in the consumer price index. At the end of each year, the investor would be required to recognize 25 percent of the real increase in value of the investment (i.e., after adjusting for the inflation rate) over the course of the year. The remaining 75 percent of increased value would be deferred until the succeeding year, to be taxed (together with any real increase in value during the succeeding year) under the same formula (i.e., 25 percent of the 75 percent would be taxed in the succeeding year). Any remaining untaxed increase in value would be taxed on disposition of the investment. The plan generally would treat losses in the same manner as capital gains.[4]

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[1] The Tax Equity and Fiscal Responsibility Act of 1982 suspended the otherwise allowable cost-of-living adjustment for the years 1983, 1984, and 1985.

[2] Finance Act 1982, secs. 86, 87.

[3] Budget Speech, delivered in the House of Commons by the Honourable Marc Lalonde, Minister of Finance, April 19, 1983. Canada has indexed personal income tax brackets and exemptions since 1974.

Investors would be allowed to transfer presently held securities to an ISIP. However, these securities would be indexed only for the period beginning in 1983.

The Canadian Government plans to deny an interest deduction on funds borrowed for ISIP investments.

Explanation of the Bill

Overview

The bill would provide generally for an inflation adjustment to (i.e., indexing of) the basis of certain assets for purposes of determining gain or loss on disposition. Assets eligible for the inflation adjustment would be certain corporate stock and real property. The adjustment would be applicable only to assets held for more than one year.

The adjustment would be based on the level of the gross national product (GNP) deflator for the calendar quarter in which disposition takes place compared with the deflator for the quarter in which the asset was acquired. The inflation adjustment would apply only to inflation occurring after 1983.

Under the bill, the inflation adjustment would apply with respect to sales, exchanges, or other dispositions of property. However, the adjustment would not apply for purposes of determining any deduction for depreciation, cost depletion, or amortization.

Indexed assets

Stock.—The bill would generally provide for the indexing of corporate stock which is a capital asset. (For this purpose, options, warrants, or other contract rights with respect to stock would not be considered stock.) However, no adjustment would be allowed in the case of preferred stock which provides for a fixed return with no significant participation in corporate growth. The inflation adjustment also would not apply to stock in an S corporation, in a personal holding company, or, in general, in a foreign corporation.[5] An interest in a common trust fund would be treated as stock.

Realty.—The bill would provide for indexing of real property (or any interest therein) which is a capital asset or property used in a trade or business (within the meaning of sec. 1231). This includes land, leasehold interests, and buildings. However, the inflation adjustment would not apply (1) to any contract rights with respect to real property which are not themselves real property, (2) to any mortgage or other creditor's interest, or (3) to realty subject to certain long-term net leases.

General requirements.—The bill would apply only to assets held for more than one year. An asset would not be treated as an indexed asset for any period during which the taxpayer, or his or her spouse, has sold short property substantially identical to the asset.

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[4] Canadian law generally requires that only one-half of recognized capital gain be included in income. Thus, under an ISIP, one-half of 25 percent of increased value would actually be subject to tax in each year.

[5] However, the inflation adjustment would apply to stock in foreign corporations which is traded on an established domestic securities market, other than stock in foreign investment companies or stock held by persons subject to potential dividend treatment on the sale of the stock.

Computation of inflation adjustment

The inflation adjustment under the bill would be computed by multiplying the taxpayer's adjusted basis in the indexed asset by the ratio of the GNP deflator for the calendar quarter in which disposition of the asset takes place to the deflator for the quarter in which the asset was acquired.[6] For example, if the deflator at the time of sale was 50 percent higher than at the time of acquisition, the gain or loss would be determined by reducing the sales proceeds by an amount equal to 150 percent of the asset basis at the time of acquisition.

If the inflation adjustment exceeds the amount of gain (determined without the adjustment) on disposition of an indexed asset, the taxpayer would recognize a loss to the extent of the excess. However, any loss created (or increased) by application of the inflation adjustment would be treated as a capital loss, regardless of other provisions of the Code.

In the case of an asset acquired before 1984, the GNP deflator for the quarter ending December 31, 1983, would be used to compute the inflation adjustment. Thus, the bill would not provide an adjustment for inflation occurring before 1984.[7]

Pass-through entities

Under the bill, partnership interests and stock of S corporations would not be treated as indexed assets. However, any adjustment made with respect to assets held at the entity level would be passed through to the partners or S corporation shareholders for purposes of determining gain or loss on disposition of their partnership interests or stock.

Special rules would apply in the case of regulated investment companies (mutual funds), real estate investment trusts, and common trust funds which hold indexed assets. In general, stock in these entities would qualify for partial indexing based on the ratio of the value of the indexed assets held by the entity to its total assets.

Special rules

The bill would disallow the inflation adjustment in cases of transfers between related persons except to the extent the transferee has a carryover basis in the asset. Also, the bill would authorize the Treasury Department to disallow all or part of an adjustment if the principal purpose of a transfer of an asset is to create or increase an inflation adjustment (or to increase a deduction by reason of such adjustment).

The bill also would provide that, if the inflation adjustment has already been applied to an asset while it was held by the taxpayer, the taxpayer may not claim a date of acquisition prior to the date on which the adjustment was applied. This would prevent a taxpayer from benefitting twice from an adjustment for the same period.

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[6] The GNP deflator is an index of the price of all goods and services produced in the United States in the relevant quarter. By contrast, the consumer price index measures the price of consumer goods (including imports) during the relevant period.

[7] Although the language of the bill as introduced refers to inflation occurring after December 31, 1984, it is understood that the bill is intended to take into account, as well, inflation occurring during 1984.

The bill would provide that, in cases where a corporation is treated as a collapsible corporation with respect to a distribution or sale of stock (sec. 341), the full amount of gain which would be recognized and taxed as ordinary income under present law would continue to be so treated.

Effective Date

The bill would apply to dispositions of indexed assets after December 31, 1983.

Prior Congressional Action

In 1978, the House passed a provision similar to the bill as part of H.R. 13511, the Revenue Act of 1978. That provision was deleted in conference.

In 1982, the Senate passed a similar provision as part of H.R. 4961, the Tax Equity and Fiscal Responsibility Act of 1982. That provision was deleted in conference.

2. S. 1579—Senator Armstrong

Charitable Expense Deduction for Use of Passenger Automobile

Present Law

Individual taxpayers who itemize their deductions may deduct charitable contributions made to qualified organizations, subject to certain limitations (Code sec. 170(a)).

Individuals who do not itemize deductions may also deduct charitable contributions, subject to limitations (sec. 170(i)). For 1982 and 1983, the deduction is limited to 25 percent of the first $100 of contributions, or a maximum deduction of $25. For 1984, the contribution limit is raised to $300, or a maximum deduction of $75. For 1985, the deduction is allowed for 50 percent of contributions, with no dollar limit, and for 1986 the deduction is allowed for 100 percent of contributions (subject to the general limitations). This provision expires after 1986.

Under present law, a taxpayer may deduct unreimbursed out-of-pocket expenses incurred incident to the rendition of services provided to a charitable organization, such as fuel costs for a vehicle (Treas. Reg. sec. 1.170A-1(g)). In determining the amount of the contribution deduction attributable to the operation of a vehicle, the taxpayer may deduct actual expenses or, may use a standard rate. As most recently established, this rate is nine cents a mile.[8] Under either computation method, the taxpayer may also deduct parking fees and tolls, but may not deduct general repair or maintenance expenses, depreciation, or insurance.

Explanation of the Bill

Under the bill, taxpayers could determine the amount of their charitable contribution deduction for the use of a passenger automobile under the standard mileage rate applicable for that year in computing the business expense deduction (sec. 162) for business use of a passenger automobile.

As most recently established, the standard mileage rate which may be used in computing the business expense deduction for business use of a passenger automobile (if the vehicle is not fully depreciated) is 20 cents a mile for the first 15,000 miles of business use during the taxable year, and 11 cents a mile for each additional mile.[9]

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[8] This rate was established in a revenue procedure issued by the Internal Revenue Service (Rev. Proc. 82-61, 1982-2 C.B. 849).

[9] Rev. Proc. 82-61, *supra* note 8.

Effective Date

The provisions of the bill would apply to taxable years beginning after 1982.

3. S. 108—Senators Grassley, Jepsen, Durenberger, and Thurmond

Tax Incentives for Vocational Education Programs

a. Increased charitable deduction for contributions of equipment to postsecondary vocational education programs

Present Law

In general, the amount of charitable deduction otherwise allowable for donated property must be reduced by the amount of any ordinary gain which the taxpayer would have realized had the property been sold for its fair market value on the date of the donation (Code sec. 170(e)).

Thus, a donor of inventory or other ordinary-income property (property the sale of which would not give rise to long-term capital gain) generally may deduct only the donor's basis in the property, rather than its full fair market value. In the case of property used in the taxpayer's trade or business (sec. 1231 property), the charitable deduction must be reduced by the amount of depreciation recapture which would be recognized on sale of the donated property.

Under a special rule, corporations are allowed an augmented charitable deduction for donations of newly manufactured scientific equipment or apparatus to a college or university for research use in the physical or biological sciences (sec. 170(e)(4), enacted in the Economic Recovery Tax Act of 1981).[10] The augmented deduction is generally for the sum of (1) the corporation's basis in the donated property and (2) one-half of the unrealized appreciation (i.e., one-half of the difference between the property's fair market value determined at the time of the contribution and the donor's basis in the property). However, in no event is the deduction under the special rule allowed for an amount which exceeds twice the basis of the property.

Explanation of Provision

Overview

Section 1 of the bill would provide an augmented charitable deduction for taxpayers (not limited to corporations) making certain donations of tangible personal property to a public community college or public technical institute (within the meaning of sec. 742(b) of the Higher Education Act of 1965 [11]), or any other institution of

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[10] Under a special rule enacted in 1976, an augmented charitable deduction also is allowed for corporate contributions of certain types of ordinary income property donated for the care of the needy, the ill, or infants (sec. 170(e)(3)).

[11] Section 742(b) of the Higher Education Act of 1965, as amended, defines a public community college or public technical institute as an institution of higher education which is under public supervision and control, and is organized and administered principally to provide a two-

Continued

higher education (within the meaning of section 1201(a) of such Act [12]), if the donated property is used for training students enrolled in a postsecondary vocational education program.

Requirements for favorable treatment

To qualify, a donation of equipment would be required, under the bill, to satisfy the following requirements:

(1) The donated property must not be transferred by the donee in exchange for money, other property, or services;

(2) Substantially all of the use of the property by the donee must be for training students enrolled in a postsecondary vocational education program offered by the donee; and

(3) The taxpayer must receive from the donee a written statement representing that the use and disposition of the donated property will be in accordance with the last two requirements.

A postsecondary vocational education program would be defined as any organized education program which is either (1) a two-year program in engineering, mathematics, or the physical or biological sciences, designed to prepare a student to work as a technician or at the semiprofessional level in engineering, scientific, or other technological fields requiring the understanding and application of basic engineering, scientific, or mathematical principles of knowledge, or (2) directly related to the preparation of individuals for paid or unpaid employment or for a career which does not require a baccalaureate or advanced degree.

Allowable deduction

If all the requirements of section 1 of the bill are satisfied, the augmented charitable deduction allowed for the donation of equipment generally would be the sum of (1) the taxpayer's basis in the

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year program which is acceptable for full credit toward a bachelor's degree, or a two-year program in engineering, mathematics, or the physical or biological sciences which is designed to prepare the student to work as a technician and at a semiprofessional level in engineering, scientific, or other technological fields which require the understanding and application of basic engineering, scientific, or mathematical principles or knowledge; and the term includes a branch of an institution of higher education offering four or more years of higher education which is located in a community different from that in which its parent institution is located (20 U.S.C. sec. 1132e–1).

[12] Section 1201(a) of the Higher Education Act of 1965, as amended, defines an institution of higher education as an educational institution in any State which (1) admits as regular students only persons having a certificate of graduation from a school providing secondary education, or the recognized equivalent of such a certificate; (2) is legally authorized within such State to provide a program of education beyond secondary education; (3) provides an educational program for which it awards a bachelor's degree or provides not less than a two-year program which is acceptable for full credit toward such a degree; (4) is a public or other nonprofit institution; and (5) is accredited by a nationally recognized accrediting agency or association or, if not so accredited, (A) is an institution with respect to which the Secretary [of Education] has determined that there is satisfactory assurance, considering the resources available to the institution, the period of time, if any, during which it has operated, the effort it is making to meet accreditation standards, and the purpose for which this determination is being made, that the institution will meet the accreditation standards of such an agency or association within a reasonable time, or (B) is an institution whose credits are accepted, on transfer, by not less than three institutions which are so accredited, for credit on the same basis as if transferred from an institution so accredited. such term also includes any school which provides not less than a one-year program of training to prepare students for gainful employment in a recognized occupation and which meets the provisions of clauses (1), (2), (4), and (5). For purposes of this subsection, the Secretary [of Education] shall publish a list of nationally recognized accrediting agencies or associations which he determines to be reliable authority as to the quality of training offered. Such term also includes a public or nonprofit private educational institution in any State which, in lieu of the requirement in clause (1), admits as regular students persons who are beyond the age of compulsory school attendance in the state in which the institution is located who have the ability to benefit from the training offered by the institution (20 U.S.C. sec. 1141).

donated property and (2) one-half of the unrealized appreciation. However, in no event would a deduction be allowed for any amount which exceeded twice the basis of the property.

Effective Date

The provisions of section 1 of the bill would be effective for donations made after 1982.

b. Postsecondary vocational education instruction tax credit

Present Law

In general, employers may deduct as an ordinary and necessary business expense a reasonable allowance for salaries or other compensation for personal services actually rendered (sec. 162). Thus, a manufacturer generally may deduct reasonable compensation paid to an employee who, while regularly employed by the manufacturer in a nonteaching capacity, teaches vocational education courses part-time at a teaching institution, with or without compensation. In addition, a manufacturer generally may deduct reasonable compensation paid to a vocational education teacher regularly employed by a teaching institution who works temporarily for the manufacturer to upgrade his or her skills.

Under present law, a targeted jobs tax credit is also available, on an elective basis, to employers who hire individuals from one or more of nine target groups (sec. 51). One such group consists of youths between the ages of 16 and 20 from economically disadvantaged families who receive instruction in and otherwise actively participate in certain cooperative vocational education programs. The targeted jobs credit is not available with respect to individuals who teach vocational education courses.

Explanation of Provision

General rules

Section 2 of the bill would provide a new tax credit with respect to (1) postsecondary vocational education courses taught by qualified teaching employees of the taxpayer and (2) qualified vocational education instructors temporarily employed by the taxpayer.

The amount of the credit generally would be $100 for each postsecondary vocational education course taught by a qualified teaching employee during the taxable year (not to exceed five courses per employee per taxable year), plus $100 for each qualified vocational education instructor temporarily employed during the taxable year.

Definitions

A postsecondary vocational education course would be defined as any course of instruction which—

(1) Is offered by an institution of higher education as part of either (a) a two-year organized education program in engineering, mathematics, or the physical or biological sciences, designed to prepare a student to work as a technician or at the semiprofessional level in engineering, scientific, or other technological fields requir-

ing the understanding and application of basic engineering, scientific, or mathematical principles of knowledge, or (b) an organized education program directly related to the preparation of individuals for paid or unpaid employment or for a career which does not require a baccalaureate or advanced degree;

(2) Consists of a period of instruction which is at least equivalent to a course of instruction that provides three hours of instruction per week during an academic semester; and

(3) Has been completed before the close of the taxable year.

A qualified teaching employee would be defined as any individual employed full time by the taxpayer for the entire taxable year who taught at least one postsecondary vocational education course part-time at an institution of higher education (within the meaning of sec. 1201(a) of the Higher Education Act of 1965 [13]), does not receive any compensation from the institution of higher education, and was not a qualified vocational education instructor at any time during the taxable year.

A vocational education instructor would be defined as any individual who—

(1) Was employed full time by the taxpayer for at least three months but not more than 12 months during the two-year period ending at the close of the taxable year;

(2) Prior to this employment, taught postsecondary vocational education courses full-time at an institution of higher education;

(3) Is teaching such courses full-time at an institution of higher education at the close of the taxable year; and

(4) Is not employed by the taxpayer at the close of the taxable year.

Double benefit

Any credit allowed under the bill with respect to an employee would be in addition to any allowable deduction for reasonable compensation paid to the employee by the taxpayer.

Limitations and special rules

The amount of the vocational education instruction credit allowable in any taxable year generally would be limited to the taxpayer's income tax liability for the year reduced by (1) certain items of tax described in the last sentence of Code section 53(a), and (2) the sum of various other statutory credits allowable in the taxable year.[14]

In addition, in the case of a taxpayer who owns an interest in an unincorporated trade or business, is a partner in a partnership, is a beneficiary of an estate or trust, or is a shareholder in an electing small business corporation, the amount of the vocational education credit attributable to such trade, business or entity which would be applied against tax could not exceed the amount of the taxpayer's total tax attributable to the taxpayer's share of income from the trade, business, or entity.

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[13] See note 12, *supra*.

[14] The statutory credits which would be applied against tax before the vocational education instruction credit are: all allowable credits having a lower letter or number designation in the Code than the vocational education instruction credit (sec. 44H under the bill), except the wage withholding credit (sec. 31), the credit for certain uses of gasoline and special fuels (sec. 39), and the earned income credit (sec. 43).

Special rules governing the computation and allocation of the credit are included in the bill for controlled groups of corporations and trades or businesses under common control. The bill would also authorize the Treasury to adopt regulations governing pass-through of the credit, in the case of S corporations (under rules similar to those of Code secs. 52(d) and 52(e)), and allocation of the credit, in the case of partnerships.

Effective Date

The provisions of section 2 of the bill would be effective for taxable years beginning after 1982.

4. S. 1464—Senators Armstrong and Hart

Exemption from Divestiture Requirements of Excess Business Holdings Provision for the El Pomar Foundation

Present Law

The Tax Reform Act of 1969 imposed an excise tax on the excess business holdings of a private foundation (Code sec. 4943). Generally, under the excess business holdings provision, the combined ownership of a business by a private foundation and all disqualified persons cannot exceed 20 percent of the voting stock of the business (35 percent if other persons have effective control of the business).

The 1969 Act provided that if a private foundation and disqualified persons together had holdings on May 26, 1969 in excess of the permitted amounts under the general rules, then those holdings could be retained for an initial transitional period. Following that period, the combined holdings must be reduced to 50 percent. Ultimately, the combined holdings must be reduced to 35 percent if the disqualified persons hold, in the aggregate, no more than two percent of the business after the initial transition period. If the disqualified persons hold more than two percent, then the combined holdings may continue to be as much as 50 percent, but the foundation itself may hold no more than 25 percent of the voting stock.

Explanation of the Bill

The bill would provide that the divestiture requirements of the excess business holding provisions (sec. 4943) would not apply to a private foundation which meets the following conditions: (1) the foundation owned (directly or through a holding company), on May 26, 1969, 100 percent of the voting stock in an incorporated business enterprise substantially all of the operating assets of which are used in operating a hotel business enterprise; (2) the stock in the business enterprise was acquired by gift, devise, or bequest before December 31, 1966; (3) neither the donor nor any of the members of the donor's family was a foundation manager on or after December 31, 1956; (4) on May 26, 1969, and at all times thereafter, the hotel business enterprise is substantially the same character as the enterprise which was conducted by the corporation on the date of the last gift, devise, or bequest by any donor of any stock in the business enterprise; (5) on May 26, 1969, and at all times thereafter, substantially all of the operating assets are used in operating the hotel business enterprise; and (6) the foundation does not acquire on or after May 26, 1969, any interest in a business enterprise that would constitute excess business holdings.

It is understood that the intended beneficiary of the bill is the El Pomar Foundation of Colorado Springs, Colorado. However, any private foundation that meets the requirements of the bill would qualify for exemption from the divestiture rules.

Effective Date

The provisions of the bill would be effective on the date of enactment.

Prior Congressional Action

In 1982, the Senate passed a similar provision as part of H.R. 4961, the Tax Equity and Fiscal Responsibility Act of 1982. That provision was deleted in conference. Also, a similar provision was added by the Committee on Finance to H.R. 4577, as reported by the Committee on November 15, 1982. No further action was taken on that bill in the 97th Congress.

5. S. 1549—Senators Armstrong, Long, Durenberger, Wallop, Grassley, Symms, Bentsen, Baucus, Boren, and Pryor

Exemption from Unrelated Business Income Tax for Income from Certain Oil and Gas Property

Present Law

In general

Under present law, most organizations which generally are exempt from Federal income taxation under Code section 501(a), including any trust that is part of a tax-qualified pension, profit-sharing, or stock bonus plan described in section 401(a), are subject to tax on any unrelated business taxable income (secs. 511-514). In addition, a tax is imposed on the unrelated trade or business income of an individual retirement account or annuity (an IRA).[15] The term unrelated trade or business generally means any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of the activities for which the organization was granted tax exemption.

Under present law, a tax-exempt organization is treated as being engaged in the same activities as any partnership (whether limited or general) in which the organization invests. Accordingly, if a tax-exempt organization becomes a limited partner in a partnership that owns a working interest in oil and gas properties and the working interest is not substantially related to the organization's exempt function, the income derived from the working interest is subject to the unrelated trade or business tax.

Debt-financed property

Present law also provides that the income of an exempt trust or organization, or an IRA, from debt-financed property which is unrelated to its exempt function is subject to the unrelated business income tax in the proportion in which the property is financed by the debt (sec. 514). Debt-financed property means all property (e.g., rental real estate, tangible personal property, and corporate stock) that is held to produce income and with respect to which indebtedness was incurred to acquire or improve the property or an indebtedness would not have been incurred but for the acquisition or improvement of the property.

A special rule applies under present law to real property acquired by a tax-exempt trust forming part of a tax-qualified pension, etc., plan. Under this rule, debt-financed real property acquired by an exempt trust is not treated as debt-financed property unless one of the following applies:

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[15] Sec. 408(e)(1).

(1) the acquisition price is not a fixed amount determined as of the date of acquisition;

(2) the amount of any indebtedness or any other amount payable with respect to such indebtedness, or the time for making any payment with respect to the indebtedness, is partially or wholly dependent upon any revenue, income, or profits derived from the real property;

(3) the real property is at any time after acquisition leased by the trust to the seller or to any person related to the seller (within the meaning of sec. 267(b));

(4) the real property is acquired from or, at any time after acquisition, is leased to any person that bears a certain relationship to the trust; or

(5) the seller or any person related to the seller or the trust (as described in (3) or (4)) provides the trust with nonrecourse financing in connection with the acquisition and the debt is subordinate to any other indebtedness on the property or bears interest at a rate that is significantly lower than the prevailing market interest rate.

Explanation of the Bill

In general

Under the bill, certain exempt organizations would be permitted to invest in working interests in domestic oil and gas properties without incurring tax for unrelated business income. The organizations that would be eligible under this provision include exempt trusts forming a part of tax-qualified pension, etc., plans, IRAs, and tax-exempt educational organizations described in Code sections 170(b)(1)(A)(ii) or 170(b)(1)(A)(iv).

In order to qualify under the special rule, the trust or organization must receive income from the working interest in oil and gas property as a limited partner from a limited partnership. In addition, the limited partnership could not, at any time during the partnership taxable year for which an income allocation is made —

(i) allocate to the limited partners a share of any item of deduction, loss, or credit that is less than the limited partners' share of income or gain;

(ii) allocate among the limited partners any item of deduction, loss, or credit that differs from the ratio in which they share income or gain;

(iii) allocate cash distributions to partners (limited or general) in a manner that differs from the allocation of income or gain.

However, these restrictions would not apply if the allocations of depreciation, depletion, gain, or loss take account of the variation between the basis of property to the limited partnership and its fair market value at the time of its contribution to the partnership and if the allocations are permissible under Treasury regulations.[16]

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[16] Sec. 704(c)(2).

For purposes of determining whether an exempt trust or organization is a limited partner or a general partner in a limited partnership, the interests of certain related parties would be taken into account. In addition, an exempt trust or organization which is a limited partner would be treated as owning an interest in any general partner held by any other exempt trust or organization (including related persons) that is a partner in the partnership.

The bill authorizes the Treasury Department to prescribe regulations that would deny the special treatment under the bill in any case in which multi-tier partnerships or other arrangements are used for the principal purpose of avoiding the conditions of the bill.

Debt-financed property

The bill would provide an exception to the rules relating to debt-financed property for working interests in domestic oil and gas properties acquired by tax-qualified pension, etc., plans, IRAs, or certain educational organizations, which would be similar to the rules, under present law, that apply to investment by tax-qualified pension, etc., plans in debt-financed real property.

Under these rules, the exemption would only apply if the acquisition price is a fixed amount and payments are not dependent upon the profits from the property (items 1 and 2 under present law, above). However, the limitations relating to leases between related parties, acquisitions from related parties, and nonrecourse financing from related parties (items 3, 4, and 5, above) would not apply to any acquisition, lease, farm-out, or other transfer of a working interest to a person related to the general partner if the terms of the transfer are consistent with the terms of similar transfers in the same geographic area.

Effective Date

The bill would apply for partnership taxable years beginning after 1982.

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STATEMENT OF SENATOR ARMSTRONG

Not often do the House Ways and Means Committee, the full House of Representatives, Treasury Secretary Don Regan and Council of Economic Advisors Martin Feldstein agree on how to cut taxes and enact real tax reform. When they do, its worth a national celebration, replete with fireworks, hot dogs, and apple pie.

Exactly this sort of celebration should occur since these diverse interests have supported what ought to be the top tax priority of Congress—enactment of capital gains indexing.

Capital gains indexing, when enacted, will solve one of this nation's most serious tax inequities. Under current law, taxes are imposed on phoney profits and gains with the result that taxes are paid on capital gains that never actually occurred.

Legislation I have introduced corrects this problem by eliminating this tax on phantom capital gains. The legislation is simple: It permits automatic inflation increases in the basis computation of the capital gains tax. The need for this legislation is clear when current capital gains tax law is understood.

Under current law the capital gains tax is applied on the increased portion of the value of an asset prior to its sale. While assets held for several years usually increase in value, in many instances the increase is a fictional, a paper, gain. It is an inflation gain rather than a real gain in purchasing power or value. In other words in its present form the capital gains tax now imposes not a tax on profit or gain or income but merely a tax on inflation, and it amounts to an unfair levy on capital.

The legislation I am proposing removes the inflation tax by permitting taxpayers to adjust the basis of certain assets for inflation using the GNP deflator. The inflation adjustment is the percent of increase in inflation as measured by the GNP deflator from the time of the purchase of the asset or the effective date of legislation until the time the asset is sold. As a result, the capital gains tax will apply only to real gains and not to the inflation gain.

Because of the obvious tax equity this bill provides, it is no wonder then that this legislation has been—

Endorsed by the House Ways and Means Committee in 1978.

Passed the full House of Representatives that same year by an overwhelming vote.

Passed by the Senate in 1982, and this legislation would now be law had the Senate action coincided with House approval.

Supported by Treasury Secretary Don Regan when he was chairman of the board of Merrill Lynch, Pierce, Fenner and Smith.

Supported by the chairman of the President' Council of Economic Advisors, Martin Feldstein.

Endorsed by the U.S. Chamber of Commerce.

Endorsed by the U.S. Industrial Council.

There are two critical reasons why this legislation has attracted such bipartisan support: First, it corrects a serious impairment in the capital formation process. Second, it corrects a severe tax inequity. A recent report of the National Bureau of Economic Research highlights these two issues.

NBER reported that for one year, there occurred $4 billion in capital gains transactions which were subject to capital gains taxes of $1.1 billion. However, this was inflation-again tax and if there had been an inflation adjustment as proposed by my amendment in fact the capital losses would have exceeded $1 billion. In other words, the current capital gains tax prevents the sale and exchange of property and the subsequent freeing up of capital for other investment.

We have put a provision in the Tax Code which inadvertently freezes people into marginal or unproductive investments. So the first reason to be in favor of this is because it will improve the marginal efficiency of the entire economy.

Mr. President, there is another more direct and more personal reason why every taxpayer has stake in the passage of this amendment, and it is simply one of equity.

As a matter of basic fairness it is wrong to tax somebody on a gain which has not occurred. Let me give you a very specific example. Let us suppose someone bought an automobile repair business for, say $20,000 ten years ago. Let us suppose also during the last ten years the value of that business increased 106 percent in nominal dollars, and then you sold the busines.

Under the present law you would have a large capital gain. In fact, you would have the capital gain on about $21,000 to pay. In fact, there has been no real increase in value, no increase in purchasing power. All that has occurred is a depreciation in the value of money because in the last decade the GNP deflator has increased 106 percent.

What this legislation seeks to do is to avoid in the future taxing people on paper gain, an unreal gain, an inflation gain.

The question this legislation puts is this: Is it fair to put a heavy tax, indeed a tax virtually on the entire value of these properties, at the time they are sold when the increase in value results almost entirely from inflation? I think the answer to that very clearly is that it is not fair to do so.

I wish it were possible to go back and index things back to 1900 or 1940 or 1960 to take care of all of the people who are already frozen into these investments. It would be impossible to do so, however, so this legislation takes effect January 1, 1984, after which time we will not further tax inflation gains.

Mr. Chairman, I appreciate the opportunity today to examine S. 108, a bill I sponsored which provides tax incentives to industry to support technician training programs within our post-secondary vocational education system. Skill renewal and job training are central to our ability to generate economic growth and strengthen the competitiveness of American industry. In recent months, Congress has concentrated an increasing amount of attention to the role the federal government can play to curb unemployment and help build a highly skilled workforce. We have enacted, for instance, the Jobs Training Partnership Act which serves as a model for federal, state and local governments to join forces with private industry in providing workers with competitive skills. Through this measure, as well as others, we have recognized that there are not sufficient federal dollars alone, nor sufficient state or private sector resources to address the specific skill needs of industry, in the present or the future. Rather, we must combine forces to strengthen the nation's training programs.

The need for relevant and effective training programs to meet the growing demands of new technologies is well-documented. The Task Force on Skilled Trades Shortages, a coalition of trade organizations representing 32,000 plants, reports that there will be a need for 23,000 new tool and die makers and machinists each year through 1990. Yet, only 5,000 individuals are completing their apprenticeships in these trades in recent years. Furthermore, the current skills of our workforce will not be adequate even three or four years down the road. Workers will need to be trained, retrained and cross-trained in order to hold their jobs and adapt to rapidly changing technologies.

As our witnesses will testify this morning, our community and junior colleges and technical institutes have emerged as a leading resource for job training and retraining. The strength of these institutions lies in their ability to provide the kinds of technical training programs that match the needs of local industries and are reflective of current job openings. The colleges create programs in cooperation with local business and industry officials, and reshape them as technology and training needs demand. They also design special training programs at the request of business and industrial firms. Through contractural agreements with these institutions, firms are able to arrange for tailored programs to meet their individual needs. On a dramatically increasing basis, industry is turning to the community and junior colleges and technical institutes to provide the specialized "employer specific" training programs for their workers. These institutions are equipped to provide high quality instruction, which is often better and less expensive than in-house skills training.

This educational system, however, is facing some very real and immediate needs. The lack of state-of-the-art equipment has become a serious hardship to community and junior colleges in their efforts to address our skills shortage. Technical programs rely on expensive equipment which rapidly becomes obsolete in this age of exploding technology. Much of the equipment in place within our community and junior colleges has fallen far behind the state-of-the-art, particularly in the fields of microprocessing, computer-assisted design and numerical control machining. Furthermore, many colleges have found it impossible to expand into emerging fields of robotics, laser optics and other current technologies because they lack the funds to initiate such programs. States, mired in budgetary pressures of their own, have been unable to meet the equipment needs of their community colleges.

The state of Iowa, for instance, provided no funding in FY 1982 for equipment upgrading among the state's 20 community collees and technical institutes. Funding for the current fiscal year is $300,000, which is probably insufficient to meet the actual equipment needs of even one of the 20 institutions. While the federal government cannot assume financial responsibility for this lack of resources, it can encourage private industry, at a relatively minor loss of revenue, to help in underwriting the expense of modernizing training programs from which they will benefit. Some colleges have benefitted from donated equipment from businesses which they could not have purchased on their own. The state of North Carolina received over $6 million of equipment donations for vocational training purposes in the last two years.

At a very little cost to the federal government, we could encourage even greater private sector participation and support in the training process.

To assist community and junior colleges in meeting the job training demands of the future, my bill, S. 108, makes three changes in the tax code. To encourage corporations to donate equipment, my bill amends the Internal Revenue Code to increase the charitable contribution deduction which may be taken by a corporation for the donation of eligible equipment. The amount of the deduction is the taxpayer's basis in the donated property plus one-half of the unrealized appreciation of the asset, not to exceed twice basis. Under current law, a corporate donor may only deduct its basis in the property.

This provision mirrors an ERTA provision permitting a corporation to claim a deduction of the same magnitude for the donation of equipment for research or research training to an institution of higher education. My bill expands the ERTA provision by permitting a corporation to donate equipment used for vocational training to two and four year colleges, technical institutes and universities. The equipment must be donated for use in a qualified post-secondary vocational education program as defined by the Higher Education Act of 1965; furthermore, the donee must certify that substantially all of the use of the property will be for training students enrolled in qualified post-secondary vocational education programs. A qualified post-secondary vocational education program is a two-year program in applied mathematics, science or engineering and their related technical fields which directly pertains to the career preparation of students without a baccalaureate or advanced degree. To prevent abuse, the property received by the donee may not be transferred in exchange for other services or property.

My bill also addresses the difficulty educational institutions face in competing with private industry to attract and maintain qualified technical instructors. S. 108 has two provisions designed to enable teaching skills to keep pace with technological growth. First, corporations are eligible to claim a $100 tax credit for employees lent to community and junior colleges to teach vocational training courses. An employer may not claim a credit for more than 5 courses taught by each employee during a taxable year. Eligible courses are those offered in a two-year program in the fields of engineering, mathematics, physical or biological sciences designed to prepare a student to work as a technician or a para-professional. This incentive would encourage industry to contribute needed technical instruction that colleges are currently unable to provide, particularly in highly specialized technologies.

Second, my bill offers employers a tax credit of $100 if they employ a full time vocational education instructor with at least two years of teaching experience. To claim the tax credit, an employer must hire the instructor for not less than three months and not more than one year. If the instructor does not return to his or her teaching position, the corporation cannot claim the credit. This provision is designed to provide employers with a small incentive to hire community college vocational instructors. Not only would these instructors be exposed to the technological needs of the area's employers, their skills would also be upgraded by working with modern equipment. This double benefit enhances the ability of vocational education instructors to teach and place their students.

Although not a comprehensive answer to our skills shortage, I feel my bill would offer immediate and needed assistance to one of our best delivery systems for job training. It would also enhance the cooperation between the business sector and our educational institutions in providing more effective training services.

I thank the Chair for the hearing this morning on my bill, S. 108, and look forward to the testimony of our distinguished witnesses.

Senator ARMSTRONG. Today is the 107th anniversary of Colorado joining the Union. Today is Colorado day. [Applause.]

Let the record of this proceeding reflect that that announcement was well received. And I also would like to announce that we are here for the purpose of holding hearings on a series of tax reform measures which are near and dear to the hearts of the people of Colorado, and so it is a very appropriate day.

I will insert into the record of this proceeding a detailed statement on each of the bills, but they are, just for the record, S. 1600, capital gains indexing; S. 1579, charitable deduction for mileage; S. 1464, exempting the El Pomar Foundation from foundation divestiture requirements; and S. 1549, permitting pension plans and college endowments to invest in all forms of energy exploration through limited partnerships and not be subject to the unrelated business income tax.

The provisions I think of these bills are well known to the committee. And I will put a statement at length in the record. We have a very distinguished list of witnesses and we are delighted to welcome them here today.

S. 1600—CAPITAL GAINS INDEXING

May I first call on my colleague and old friend, Bill Archer, a Member of the U.S. House of Representatives for, I want to say seven terms, but that may be one too many. Is that correct?

Representative ARCHER. That is correct.

Senator ARMSTRONG. From the State of Texas, one of the foremost authorities on tax law, generally, and on indexing the Tax Code, in particular. We are delighted to welcome you and we are eager to have your statement.

STATEMENT OF HON. WILLIAM ARCHER, U.S. REPRESENTATIVE STATE OF TEXAS

Representative ARCHER. Thank you, Mr. Chairman. At the onset, I would say that we in Texas view the admission of Colorado with some mixed emotions inasmuch as you took a big chunk of the original Republic of Texas within your confines.

Senator ARMSTRONG. Could we strike that out of the record? [Laughter.]

Representative ARCHER. But to get on to the business before the committee this morning. I am pleased to have an opportunity to publicly testify on a subject that has been close to the hearts and activities of both you, Mr. Chairman, and myself over the years, which is the indexation of the cost basis of capital gains. You are the author of Senate bill 1600, and I am the author of a similar bill, H.R. 3651, in the House.

Historically, we might look back a couple of years, and in 1981 the Congress for the first time recognized in public law that inflation erodes the value of the dollars on which tax liabilities are based and index the individual tax rates for individuals in 1981. And I might say, Mr. Chairman, I would like to submit my entire testimony for the record, and I will tend to paraphrase and synthesize to the greatest degree that I can.

Senator ARMSTRONG. We are glad to have your statement in its entirety.

[The prepared written statement of Representative Archer follows:]

Prepared Statement of Congressman Bill Archer

I appreciate the opportunity to appear before this Subcommittee on behalf of legislation which would index the basis of capital assets to the rate of inflation. Senator Armstrong has introduced legislation, S. 1600, which seeks to promote this goal and I am the sponsor of similar House legislation, H.R. 3651.

In 1981 the Congress passed landmark legislation that sought to stimulate economic growth in the United States through a combination of across-the-board income tax rate reductions and reforms designed to encourage investment and savings. Among the most important of these changes was the implementation of a system of indexing for individual tax rate brackets the zero bracket amount and the personal exemption. This represented the first major recognition in Public Law that inflation erodes the value of the dollars on which tax liabilities are based. The Congress stood up and acknowledged to the American people that the automatic tax increases attributable to inflation were unfair to every American taxpayer by allowing their tax burden as a percentage of income to increase without an Act of Congress. It also recognized the adverse effect of such a policy on the incentives to both work and save. Indexing which had been used for years to establish wage and price increases in the private sector was declared to be our national policy with regard to the federal individual income tax. It is now an appropriate time to carry on from this historical beginning to fully implement this policy. I urge you to support, at the first available opportunity, legislation establishing capital asset indexing.

I first authored capital asset indexing legislation in 1978. On July 25, 1978, a bipartisan majority of the House Ways and Means Committee adopted my legislation on a 21 to 16 vote. When this legislation was considered on the House floor as part of the Revenue Act of 1978, a bipartisan coalition voted to keep it in the bill with 249 votes for it and 167 votes against it. This was the first time that any tax indexing proposal had received the affirmative approval of either the Ways and Means Committee or the House as a whole. It was regrettably deleted in the final Conference Report.

Last year, during the Senate floor consideration of the Tax Equity and Fiscal Responsibility Act of 1982, Senator Armstrong offered an amendment to index the value of capital assets subject to the capital gains tax to reflect inflation, beginning in 1985. The Senate adopted the Armstrong Amendment on a 64-32 vote and rejected a motion to reconsider by an almost identical margin. The Senate had now also affirmatively endorsed capital asset indexing. Once again, however, this amendment did not survive the House-Senate Conference Committee.

Capital gains indexing would be accomplished in both H.R. 3651 and S. 1600 by permitting taxpayers to adjust the basis of certain assets for inflation using the GNP deflator. The inflation adjustment would be computed by multiplying the taxpayer's adjusted basis for the indexed asset by the applicable inflation factor. This factor is determined by the ratio of the GNP deflator level for the quarter in which the asset was sold to the index level for the quarter of purchase or the last quarter of 1983 if purchased prior to this legislation's enactment.

Indexing would be permitted for both corporate stock and real property. The corporate stock category would specifically exclude: certain preferred stocks which provide for a fixed rate of return with no significant participation in corporate growth; stock in foreign corporations and personal holding companies; and warrants, options and other contract rights with respect to stock. The real property category would require the assets to be capital assets or assets used in a trade or business. Indexing would only apply to assets held for more than one year. This provides uniformity with current capital gains tax treatment and also would exclude ordinary income assets, such as inventory, from indexation.

The inflation adjustment could only be applied to sales, exchanges or other dispositions of property. It would not apply for the purpose of determining depreciation, cost depletion or amortization.

Where the adjustment creates or increases a loss on the disposition of an indexed asset, the additional loss is to be treated as a capital loss rather than an ordinary one.

In an effort to avoid unnecessary complexity, debt is specifically excluded from the inflation adjustment. This avoids the necessity of computing offsetting adjustments for both borrower and lender and reflects the basic ability of interest rates to rise and fall in expectation and reflection of the inflation rate.

It is important to emphasize that there is no attempt whatsoever to retroactively apply capital asset indexing. My legislation would apply only to inflationary increases in value which occur after this year. I personally would not have any serious objection to Senator Armstrong's approach of having the adjustment commence in 1985 -- at the same time that individual tax rate indexing begins. While I would optimally prefer to be able to adjust for the years of high inflation that we have experienced, I recognize the problems inherent in so doing, particularly the obvious revenue impact that such a correction would involve.

What we have before us at this time can really be reduced to a plea for fairness and rationality in our tax laws. It is obvious that this point has been made over the last few years. Rampant inflation has grossly inflated the value of those assets owned by all Americans in the same manner that it has moved people into higher and higher income tax brackets without a commensurate increase in real purchasing power. The Congress recognized this fact by indexing individual tax rates and now is the time to complete the job by indexing the method by which real profits and losses are determined.

People are motivated to save and invest by a variety of factors, one of which is their perception of the potential return that they might be able to make on their investment. Many years of high inflation have altered savings and investment patterns throughout the country and have particularly led to a precipitous reduction in the rate of savings.

In this legislation we are attempting to set a national policy that inflation will not be taxed and that government will not profit from the inflation which it causes or abets. There are no guarantees that inflation will not return, but we can guarantee that the ground rules will change if inflation soars again. Individual Americans do not benefit from the phantom profits that result from inflation. They have no real increase in their savings or their purchasing power. These illusory profits do not create jobs or wealth. They do increase government revenues while reducing the availability of private capital. They effectively discourage individuals and corporations from committing to long-term investments that are of economic benefit to our nation as a whole.

The effects of inflation-based taxation is insidious. It creates monumental differences in computing a person's real income. An individual who buys an asset for $1,000 and holds it for 10 years, at an annual inflation rate of 7 percent, would realize 100 percent compounded inflation over that 10 years, and if he sold it for $2,000 he would have no real increase in his purchasing power. Yet, he would be taxed on $1,000 of capital gains. Another individual who bought a piece of property for $1,000 and held it for 1 year and 1 day and sold it for $2,000 would be taxed also on a $1,000 capital gain but, again assuming 7 percent inflation, his real income growth would be 93 percent. Our current system of computing capital gains allows him to be taxed on the same basis as the investor who had no real income and had committed his investment for 10 times longer. Where is the incentive for long-term investment? Certainly there is none in this type of situation. The constant plea that every

Member of Congress consistently hears from the business community (and particularly the small business community) is for long term investment capital.

Capital asset indexing legislation will not protect the public from inflation but it will restore some sanity, consistency and equity to our tax laws, thus continuing the efforts that have been made in the last two years toward these goals. It will protect Americans from government taxation of inflation.

As we strive towards the dual goals of budget reduction and tax reform in this Congress, any tax legislation must be judged by its impact on the government's balance sheet in addition to its basic merit. I want once again to emphasize that we are proposing a purely prospective measure in capital asset indexing. It will not adversely affect tax revenues in current budget projections, particularly if our inflation rate continues at its present low levels. If we are ever going to correct the inequities that inflation wreaks on our tax policies, we should take advantage of this period of 3 to 4 percent inflation. It will be much harder to act if inflation rates are higher -- as we have seen in prior years when this idea was debated.

Capital asset indexing can have a major economic impact in terms of capital formation. We need to act now to add it to the arsenal of tax incentives that we have been putting into place to revitalize our economy and our nation.

Representative **Archer**. The Congress stood up at that time and acknowledged that the tax increases that were attributable to inflation were unfair to every American taxpayer by allowing their tax burden as a percentage of income to increase without an act of Congress. And I think, following up on the indexation of the individual tax rate, that it is now an appropriate time to carry out this historical beginning into full implementation by including capital asset indexing. This concept was introduced by myself in legislation in 1978, and for the first time, and on July 25 a bipartisan majority of the House Ways and Means Committee adopted and approved that legislation. It went to the floor of the House, and again on a bipartisan coalition basis as an equitable reform, it passed the House overwhelmingly. Unfortunately, it was deleted in the conference committee.

Mr. Chairman, the record should show that last year you passed similar legislation on the floor of the Senate, and you passed it overwhelmingly. Once again, unfortunately, it was eliminated in the conference committee. But the House has now acted and the Senate has now acted to approve this reform concept.

Capital gains indexing would be accomplished in both of our bills by permitting taxpayers to adjust the basis—the cost basis—of certain assets for inflation, using the GNP deflator. Indexing would be permitted for both corporate stock and real property. To provide uniformity with current capital gains tax treatment, it would exclude ordinary income assets, such as inventory, from indexation, and it would be applied only to sales and exchanges of the type of assets that are covered. It would not apply for the purpose of determining depreciation, cost depletion, or amortization. And I think that is important to understand because that would create another complexity. It also does not include debt because that would be a complexity that we believe we should not get into.

No attempt is made whatsoever to retroactively apply this capital asset indexing. I would like to do that, Mr. Chairman, because I think in equity it should be done so that we don't tax inflation. But from a revenue standpoint we recognize, both of us, that it has to be prospective. My bill would make it immediately applicable; yours would delay the prospectiveness until 1985. And I have no strong feelings about that, recognizing that it must be prospective.

What we have before us at this time can really, in my opinion, be reduced to a plea for fairness and rationality in our tax laws. It is obvious to me that we have tried to do this over the years, and this is one area where we still have an opportunity to do a great deal more.

We are attempting to set a national policy that inflation will not be taxed, and that Government will not profit from the inflation which it causes and abets. There are no guarantees that inflation will not return, although it is at a very low level today. But we can guarantee that the ground rules would change if inflation soars again. Individual Americans do not benefit from the phantom profits that result from inflation.

I would like to cite an example. If an individual buys a capital asset—land or, say, corporate stock, for example—and pays a thousand dollars for it, and holds it for 10 years at a rate of inflation of 7 percent, compounded, that is 100 percent over 10 years. If that individual then sells that asset for $2,000 10 years later, the amount of actual purchasing power the individual has is no different than he or she had 10 years earlier. And yet that individual has the pleasure of being able to pay capital gains tax on a thousand dollars of capital income; after paying the tax, being reduced to a position of less purchasing power than they had 10 years earlier.

On the other hand, an individual could buy an asset for a thousand dollars, hold it for 1 year, and if they had been extremely sagacious in their investment, double their money, and pay the same tax that the individual who had held it for 10 years paid, and yet they would have a real gain because there was only 7 percent inflation during that 1 year. So in equity I think we need to iron this out between investors, and I think we need to encourage the investment in capital assets, particularly toward high risk type business and entrepreneurial businesses. And I believe that our legislation will go a long way in encouraging that.

In addition, I personally believe that we would free up the transfer of a lot of assets that are frozen because people do not want to sell them where they have large amounts of capital gains that have occurred over a period of 20 or 30 or 40 or 50 years. And that would be a very healthy thing for the market. It would increase the volume and, in my opinion, would actually have a great opportunity to increase the revenue rather than to reduce the revenue from capital gains.

If we are ever going to implement this type of legislation, it seems to me that now is the time to do it when we do have a low inflation rate. I think that it is an idea whose time has come. I compliment the chairman for his interest in this legislation, and I intend to pursue it to the greatest degree possible in the House.

I might add as sort of an addendum, Mr. Chairman, that what we are urging here is something that is being picked up in other parts of the world. Canada and England have recently gone in to similar types of approaches for the treatment of taxes on capital assets. And I think it is high time that this country also pursue this endeavor in the name of equity and reform. I thank the chairman. I will be glad to respond to any questions.

Senator ARMSTRONG. We are grateful to you not only for your statement this morning and for your additional observations, but I am especially grateful for the leadership you have shown on this issue. There are a lot of people in and out of the Congress who have been pushing the idea of indexing the capital gains basis, but I don't know of anyone who has been a more forceful advocate of this or who got out in front on the issue earlier than you did or who has done more to bring this concept to the floor.

Victor Hugo said that "greater than the threat of a mighty army is an idea whose time has come." I am hoping that the time has come for this. And the question that I would put to you is a very simple one: How do you evaluate the prospects that we might be able to get this through the House, either as a separate bill or if somehow I could hang it on as an amendment here in the Senate? What are the chances we could get the House to buy something like this?

Representative **Archer**. Well, Mr. Chairman, it seems to me that as far as getting it affirmatively adopted in the House, it probably would have to be part of some kind of packaged tax bill. If you are able to get it passed again in the Senate, inasmuch as the House has passed it—and we do have a record of support in the Ways and Means and on the floor of the House—I would hope that we would have a reasonable chance to hold it in the conference this time, particularly with the economic conditions that exist with low inflation today, and also with the reform concept that says to everyone, Democrats and Republicans, liberal and conservative, that this creates equity between different holders of capital assets.

Senator **Armstrong**. Well as you know, my colleagues here on the Finance Committee love to put together packages, so we will try and send something that we can buy. And I again thank you for coming this morning.

Representative **Archer**. I wish you Godspeed, Mr. Chairman. Thank you for this opportunity.

Senator **Armstrong**. Thank you very, very much. We appreciate your coming.

We are next very pleased to recognize and welcome Representative Barbara Mikulski, who I believe is going to testify on the mileage bill, of which she has been a strong advocate and a leading spokesman in the House. And, of course, we will be glad to hear her views on any of the measures that are before us this morning. But, Representative Mikulski, I am aware that you have been beating the drum for this charitable deduction issue in the House, so we are really pleased to have you here this morning and are looking forward to your testimony.

STATEMENT OF HON. BARBARA MIKULSKI, U.S. REPRESENTATIVE, STATE OF MARYLAND

Representative **Mikulski**. Thank you very much, Senator. And I appreciate the chance of being able to testify in support of the bill, Senate 1579, which you have taken the leadership for here in the U.S. Senate.

As you know, what the legislation does is raise the mileage deduction that a volunteer now takes from approximately 9 cents a mile to 20 cents a mile, which in effect would be the same business deduction that business takes for its mileage deduction. There are those of us who believe that the business of being a volunteer is part of the business of America. Volunteers are a major part of our labor force. Together, they contribute over $100 billion to this Nation, measured in times and services. So when we think about the volunteers we have to think about the candy stripers, the scout leaders, the veterans, the Kiwanis Club, the people who deliver Meals on Wheels, the people who run telethons.

The volunteer's time cannot be measured and should not be measured in time and money alone. We must measure it in terms of the values that they bring to our society, a sense of caring, and a heartfelt motivation to make the world just a better place, the kinds of things you just can't do with your contract with the bureaucracy.

Our volunteers are working at full capacity and it is time we recognized this. With the tremendous loss in federal social programs, there is a new call to our volunteer community to step forward and fill the vacuum.

We seem to assume somehow or another that volunteers are immune to society's pressures that also affect business. Right now we have tax credits for oil companies and expense accounts for executives, but volunteers are somehow or another expected to be an endless reservoir of resources, money and energy.

Inflation has affected the nonprofit world in the same way as it has affected Government and profitmaking organizations. The women who work at the auxiliary at the hospital are under pressure to contribute additional money to the family. That Boy Scout leader may be also looking for a second job or he might have been laid off at the steel, housing, or automobile industry. The Meals on Wheels volunteers may be helping out grandma because her medical care costs have increased, or it might be grandma herself whose COLA has been delayed by 6 months in social security. In fact, many volunteers are on fixed incomes themselves. Times are just as tough for the volunteers as they are for the mega corporations, and yet somehow or another we expect the volunteers to give more and more.

Everyone has been conscious about out-of-pocket expenses. Many volunteers have to travel miles and miles to do their good work, driving to meetings, youth centers, and so on. Three million of our volunteers give volunteer time to the Federal Government, working in the parks, visiting veterans at the VA hospitals, those forgotten people from Vietnam and even Korea; the Coast Guard Auxiliary, who really performs a very important link in backing up our Coast Guard, particularly in the area of maritime safety. In terms of the Federal Government, they can do more.

What I want to do is not create a new tax loophole, what I want to is something on behalf of the good guys, the good samaritans in our society, men and women who are out there helping their neighbors and ours. They never ask for a reward.

Mr. Chairman, I could give lots of examples of what this legislation would do. And when we come down to it, the cost of gasoline is a serious threat to the kind of neighbor helping neighbor society as we Americans are so proud of.

In my own community, Meals on Wheels delivers over 2,000 meals a day. That keeps 2,000 people out of nursing homes. The cost savings in just preventing institutional care is outstanding. I don't want to lose the volunteer programs, but I don't think we can have this kind of work done, and I don't think we can have it done by salaried employees. What we need to do is be able to back up our volunteers and give them an adequate mileage deduction so they can go on doing what they do best. I am deeply concerned because the American people are now suffering under the largest cutbacks in Government programs. Thousands of Government programs providing essential services have been eliminated. Therefore, the need for charitable organizations—nonprofits and volunteers—is enormous. It is imperative that our Government adjust its tax policy to enable citizens to perform these good samaritan works. I urge this committee to take action to keep volunteers on the road in the programs that are so very much needed.

And I thank you for offering me the opportunity to testify, and I ask unanimous consent to submit my entire statement for the record.

Senator **Armstrong**. Yes. We would like to have the whole statement in the record, and we will publish it as a part of the record of this proceeding.

[The prepared statement of Representative Mikulski follows:]

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3D DISTRICT, MARYLAND

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HEALTH AND THE ENVIRONMENT
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August 1[illegible] 1983

TESTIMONY BEFORE THE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

RE: S. 1579/H.R. 2697

Barbara Mikulski

Mr. Chairman, I appreciate being given the chance to testify in support of Senator Armstrong's bill, S. 1579, which is identical to my Volunteer Mileage Bill, H.R. 2697.

Volunteers are a major labor force in the United States. Together they contribute some $111 billion to this nation measured in time and services. They are the candy-stripers, the scout leaders, the civil rights activists, the veterans, the chamber of commerce members, the Kiwanis Club, the Blue-Chip-In participants, the meals on wheels bringers, the donaters and the telethoners.

But the volunteers' contribution cannot be measured, and should not be measured, in time and money alone. We must also measure it in terms of the value system it represents -- a sense of caring, and a heartfelt motivation to make the world just a little bit better. Our volunteers are working at full capacity, selflessly and effectively. It is time that we return something to these tireless individuals.

With the tremendous losses in federal social programs there is a new call to our volunteer community to step forward and fill the vacuum. Volunteers have been asked to substitute for the drug rehabilitation programs, the aid to the handicapped, the loss of CETA, and a host of other needed social programs. Its a tall order and the volunteers are going to need help.

WE ALL SEEM TO ASSUME THAT VOLUNTEERS ARE SOMEHOW IMMUNE TO THE SOCIETAL PRESSURES THAT AFFECT BUSINESSES. THERE ARE TAX CREDITS FOR OIL COMPANIES, AND EXPENSE ACCOUNTS FOR EXECUTIVES, BUT VOLUNTEERS ARE SOMEHOW EXPECTED TO BE AN ENDLESS RESERVOIR OF RESOURCES, MONEY AND ENERGY.

INFLATION HAS AFFECTED THE NON-PROFIT WORLD IN THE SAME WAY THAT IT HAS AFFECTED GOVERNMENT AND PROFIT-MAKING ORGANIZATIONS. THOSE LADIES WHO WORK THE AUXILIARY AT THE HOSPITAL ARE UNDER PRESSURE TO CONTRIBUTE ADDITIONAL INCOME TO THE FAMILY. THAT BOY SCOUT TROOP LEADER MAY BE LOOKING FOR A SECOND JOB, OR MAY HAVE BEEN LAID OFF FROM OUR STEEL, HOUSING, OR AUTO INDUSTRY. THAT MEALS ON WHEELS VOLUNTEER MAY HAVE TO HELP OUT GRANDMA BECAUSE HER MEDICARE COSTS HAVE INCREASED. IN FACT, MANY VOLUNTEERS ARE ON FIXED INCOMES THEMSELVES. TIMES ARE JUST AS TOUGH FOR THE VOLUNTEER AS FOR THE MEGA-CORPORATION, AND YET WE BLITHELY EXPECT THE VOLUNTEERS TO GIVE MORE AND MORE.

EVERYONE HAS BECOME MORE CONSCIOUS OF OUT-OF-POCKET EXPENSES. MANY VOLUNTEERS HAVE TO TRAVEL MILES AND MILES TO DO THE GOOD WORK THEY DO -- DRIVING TO MEETINGS, TO YOUTH CENTERS, TO VISIT THE HOUSEBOUND. THREE MILLION OF OUR VOLUNTEERS ARE GIVING THEIR RESOURCES TO THE FEDERAL GOVERNMENT, WORKING IN PARKS, FOR THE VETERANS ADMINISTRATION, THE COAST GUARD AUXILIARY. IN TURN THE FEDERAL GOVERNMENT SAYS, "DO MORE."

I CAN HONESTLY SAY THAT I AM NOT ASKING FOR SPECIAL TREATMENT FOR A PRIVILEGED FEW, OR A NEW LOOPHOLE FOR SOME WOULD-BE TAX EVADERS. I SUBMIT THIS TESTIMONY ON BEHALF OF THE "GOOD GUYS" OF OUR SOCIETY -- MEN AND WOMEN -- WHO ARE OUT THERE EVERY DAY HELPING THEIR NEIGHBORS AND OURS. THEY HAVE NEVER ASKED FOR A REWARD; BUT NOW THEY ARE ASKING FOR RELIEF. IF IT COSTS 20 CENTS A MILE TO OPERATE A CAR FOR GOVERNMENT PURPOSES, IT COSTS JUST AS MUCH TO USE IT AS A VOLUNTEER. AND IT IS TIME THAT WE RECOGNIZE THAT ECONOMIC REALITY OF LIFE.

All over the United States right now, volunteers using their own cars are providing essential services to their fellow citizens. In my own community of Baltimore in 1980, Meals on Wheels of central Maryland served 2,050 meals every day -- driving 150,000 miles a week. Life Support Project volunteers visit elderly nursing home patients who would otherwise have no visitors. In 1980, they made over 6,500 visits to people in nursing homes. I know of two patients in cancer clinics who were driven to treatment 40 times for a total of 2,894 miles.

These are just some of the examples of the work done every day by volunteers, without salary, without payment -- and too often without recognition of any kind, but now these programs are in trouble. The cost of gasoline is a serious threat to the kind of neighbor-helping society we as Americans are so proud of. Every day, we learn of more programs which have had to cut back, to retrench, to deny services to needy clients -- because they do not have enough drivers.

I do not want to lose the volunteer programs that are the bonding fabric in our society. I do not think we can afford to have this kind of work done by salaried employees. We cannot afford it financially -- and we cannot afford it spiritually.

Finally, I am deeply concerned because the American people are now suffering under one of the largest cutbacks in government programs in our nation's history. Thousands of government programs providing essential services to millions of Americans have been eliminated. The need for charitable organizations and volunteers to fill this void is enormous. It is imperative that our government adjust its tax policy to encourage citizens to perform charitable works.

I urge this Committee to take action to keep volunteers in the programs and on the roads -- pass S. 1579. Thank you.

Senator **Armstrong**. I really like your characterization of this as the Good Samaritan mileage bill. I have been calling it when I have spoken on it and described it as the charitable mileage deduction. But really, Good Samaritan sums it up so well, and I am going to borrow that notion from you.

Let me ask this. Some people who oppose this legislation make the argument that volunteers should not expect to be reimbursed for their cost. In effect, they say that if they are really good samaritans they would not care about this deduction issue. What is your response to that?

Representative **Mikulski**. Well, Senator, my response to that is that, No. 1, we are not reimbursing them for their time. We are reimbursing them for their out-of-pocket expenses. There is a precedence for that within the Federal Government in the way we reimburse those wonderful volunteers who work for CAB and the Coast Guard Auxiliary for their fuel expenses because that is the only way they can volunteer.

Second, one of the things that also emerges is that many volunteers really are on fixed incomes themselves. And the Meals on Wheels program in Baltimore, the average volunteer is over the age of 60, him or herself. And what we are talking about is reimbursing for expenses and not paying them for their time, which means we are not renting volunteers for their services, we are only reimbursing them for their out-of-pocket expenses.

And, Senator, I think maybe that would be a good argument when gas was 30 cents a gallon. When it hit 50, I think the argument got a little bit more shaky. I think now that it is up to $1.30 a gallon, of which we even posed an even higher gas tax on the volunteers to rebuild America's infrastructure, I think that argument just isn't valid any more.

Senator **Armstrong**. Well, I certainly agree with your characterization of it. And, of course, all we are really permitting people to do in this instance is to deduct this from the computation of their tax. It isn't really a reimbursement in the sense that, for example, a salesman that might go to call on a hospital to sell medical supplies would actually be reimbursed for his expenses by his employer. We are just saying that a candy striper or some of the others that you mentioned ought to be able to take a tax deduction for a reasonable amount. And I understand that this mileage amount has only been raised twice in all the time it has been on the books. And so it is way beyond what is fair already. It has fallen far behind the rate of inflation.

Representative **Mikulski**. Well, that is exactly right, Senator. And you know, a volunteer undertakes not only gasoline expenses, but substantial insurance expenses on their own as they deliver meals or as they drive handicapped or ill people to needed services. One of the important services volunteers now do is drive people who have no other means to their chemotherapy, and cancer, and other life support mechanisms. So, yes, I would agree with your rationale as well.

Senator **Armstrong**. I don't want to put you on the spot about it, but do you have any sense of what the sympathy of the House would be for legislation of this type?

Representative MIKULSKI. Mr. Armstrong, I believe that the House would pass such legislation if it could be brought before it. In the last session of the Congress we had over 100 cosponsors. And I believe we could up that even more.

In all candor to you, Senator, I am not as equally as optimistic about the Ways and Means Committee or the leadership on the Ways and Means Committee. We find that we can move tax deductions for megacorporations a lot easier than we can move mileage deductions for volunteers. But we find that that is true of any humanitarian orientation in the Tax Code.

However, the organizations who back this legislation I know are creating a major drive in the House, and we feel that when the House comes up with the new tax package, to begin, this will not stand on its own, but we could have a better opportunity at it. And I think also the groups will now be focusing more attention on it, and therefore, the Congress. You know, when those volunteers start—I don't think people realize how many people volunteer, Senator. There is a myth that somehow or another the volunteer is a rich, affluent woman, usually over the age of 48, who, when she is not gawking over her trust fund, comes out and does good. We don't realize the thousands, even millions, of people who volunteer at all income levels. When those veterans start writing for the volunteer mileage bill, and other groups in our society, I think the House will pay more attention to us.

Senator ARMSTRONG. You know, this isn't the time and place to get into it, and I don't want to take it too far afield, but I really share your enthusiasm for volunteers, not only for the literal value of the services they provide which are so urgently needed by many parts of our society, but more than that for the quality and the spirit that they bring to the communities. And I have seen so many specific instances in my own State of how the quality of life is enhanced for the whole community because of this outpouring of interest and concern and affection by volunteers who get involved in local community projects. And you can't measure that in dollars; it goes far beyond that.

Representative MIKULSKI. Right.

Senator ARMSTRONG. Well, I'll say the same thing to you that I did to Bill Archer. If you can get this included in a package from the House, I will fight for it over here. And when we are packaging up some things in the Finance Committee I will see if I can get it added to the list. I think there is substantial interest in this issue here in the Senate. And when we see a vehicle moving, I will try and get this aboard. Thank you very much for coming.

Representative MIKULSKI. Thank you very much, Senator. And thank you for your cosponsorship.

Senator ARMSTRONG. We are now pleased to welcome and invite the testimony of Mr. Ronald A. Pearlman, Deputy Assistant Secretary for Tax Policy from the Treasury Department. Mr. Secretary, we welcome you, and I hope that you will share the enthusiasm of our other witnesses for the proposals that are before the committee.

STATEMENT OF HON. RONALD A. PEARLMAN, DEPUTY ASSISTANT SECRETARY FOR TAX POLICY, DEPARTMENT OF THE TREASURY, WASHINGTON, D.C.

Mr. PEARLMAN. Mr. Chairman, it is a pleasure to be here. Thank you very much. My statement is rather lengthy and I am not going to bore you with it. We will submit it in its entirety, and I will try to summarize our views on each of these five bills before you.

Senate bill 1600, the capital gain indexing provision, would add to the Internal Revenue Code a new provision designed to prevent the taxation of inflationary increases in the dollar value of certain qualifying property. I think it is important, because of our evaluation of this bill, to point out that it is limited to only certain property, certain common stock and certain real property. For example, tangible personal property would not be subject to indexing.

We recognize and indeed are sympathetic to the argument that exempting inflationary gains from income tax is a desirable objective, but, unfortunately, we must oppose Senate bill 1600 based on three major concerns: First, that it is a limited approach to indexing for inflation, which we think will create economic distortions among investors in different types of assets; second, that the bill contributes a rather significant level of complexity to the law; and, third, that we think it would duplicate the effect of provisions that are already in the law to indirectly adjust for inflation.

Senate bill 1600 is a limited proposal. It indexes only certain assets at certain times for certain purposes. This partial indexing necessarily creates inconsistencies between the tax treatment of indexed and nonindexed assets. We think these inconsistencies would cause undue economic distortion. The bill indexes common stock and real property, but no other property. Bonds, tangible personal property, and all other property would be subject to taxation without regard to inflation. However, the measurement of gain or loss on the disposition of these other types of property is affected by inflation just as much as inflation affects gain or loss on common stock and real property.

The only way to really deal with this problem is to index all assets. When you don't index all assets you create a mismeasurement of income when you compare different types of property.

The bill also introduces a mismeasurement when you look at qualifying property that is leveraged. Although a debtor benefits as inflation reduces the real burden of debt, and although a creditor is detrimented as inflation reduces the amount of repayment, Senate bill 1600 disregards the effect of inflation on both the borrower and the creditor.

We think Senate bill 1600 is rather significantly complicated. The best example is the bill's treatment of conduit entities, namely, regulated investment companies, real estate investment trusts, and common trust funds. Here the bill splits ownership interests in these entities into an indexed portion and a nonindexed portion in proportion to the ratio of the qualified property these entities own to the nonqualified property, and then requires that these calculations be done on a monthly basis. Therefore, if an investor in a mutual fund, for example, owns stocks and bonds, sells his interest after owning the investment in the mutual fund for 10 years, he would be required to make 120 separate inflation adjustments to determine his tax on sale.

The distortions and complexity that would result from Senate bill 1600 are particularly troubling to us since current law does contain some provisions that soften the effect of inflation. The inflation adjustment would duplicate, for example, the approximate adjustment provided in current law by the preferential tax treatment of capital gains. As you know, noncorporate taxpayers currently are entitled to deduct 60 percent of their net capital gain in determining taxable income, and corporate taxpayers are entitled to a favorable 28-percent rate on capital gains.

Moreover, in the case of depreciable real property, the bill would duplicate to some extent the approximate inflation adjustment provided by ACRS.

We recognize the importance of trying to deal with the problem of inflation in the tax system. Unfortunately, we think Senate bill 1600 just addresses part of the problem, and that only a comprehensive solution to the inflation problem that indexes all assets and all liabilities for all purposes, including depreciation, can avoid the distortion and duplication inherent in any limited approach. Unfortunately, full indexation would substantially increase complexity in a tax system which is already criticized as being too complex. Consequently, we cannot recommend at this time indexing of basis as a solution to the problem of income mismeasurement resulting from inflation.

I do want to note that we do not think that our objection to Senate bill 1600 is inconsistent with our support of the rules enacted in ERTA relating to indexing tax brackets. The ERTA rules apply across the board and will not create economic distortions. Bracket indexing is simple, as it merely requires the IRS to make changes in the tax tables. We think the ERTA rules are sound fiscal policy.

I would like now to turn to Senate bill 1579, which deals with the increase in the standard mileage rates for charitable contributions. We acknowledge that a reasonable argument can be made for using the same mileage rate to measure the cost of using an automobile for charitable purposes as is used when using an automobile for business purposes. On the other hand, we think there are sound reasons for the different rates used under current law. Allowing the lower mileage rate for charitable purposes reflects the longstanding position that the only deductible expenses eligible for the charitable deduction are so-called out-of-pocket expenses. That is, under current law, the administrative position is that no deduction is allowed for a proportionate share of maintenance, general repairs, depreciation or fixed costs, such as insurance or registration fees. And there are several reasons, in fact, for this position. First, section 170 of the code requires that a contribution be paid to or for the use of a qualifying charity. Fixed or general expenses which would be incurred without regard to whether the vehicle were used for charitable purposes cannot be said to be paid to or for the use of the charity. Second, it is difficult to identify and quantify the amount of the indirect cost. And, third, it is difficult always to insure compliance in this area, even under current rules. And to allow the deduction for these indirect costs would simply complicate the problem.

I would note also that the rationale underlying these limitations applies not only to the use of personal automobiles but to other problems. For example, there is a longstanding position that the rent-free use of nonbusiness real estate is not deductible for purposes of calculating the charitable contribution. Thus, mileage for automobiles are not treated inconsistently. In all cases, it is the position that fixed costs, such as depreciation, insurance, maintenance, and repairs, are not deductible.

We think that the current rules provide a proper measure of the charitable deduction. In most cases, the current rate is adequate to cover the incremental costs attributable to rendering a charitable service. And I think it is important to point out that if a taxpayer thinks that the standard mileage rate is inadequate to cover his actual expenses for gas and oil, the taxpayer is always eligible to show actual out-of-pocket costs to document those costs. I think much of the sympathy for this bill may well be coming from the fact that escalation and fuel costs might support an argument that the current mileage reimbursement rate is too long. And I would point out that if a taxpayer wishes to keep accurate records and provide actual information on fuel costs, then those actual fuel costs are deductible under current law, and the taxpayer simply will not, in that case, use the mileage rate.

Senate bill 108 provides certain tax incentives for postsecondary vocational educational programs. Section 1 of Senate bill 108 would allow a taxpayer a larger deduction in the case of contributions of inventory or certain other ordinary income property—which is tangible personal property, of course—to a public community college or public technical institution or other institutions of higher education if substantially all of the use of the property is for the training of students enrolled in a postsecondary vocational educational program.

We are opposed to section 1 of Senate bill 108. The bill would create a new open-ended Federal program funded by the Treasury but administered by private taxpayers to place equipment in schools for use in postsecondary vocational programs. The donor would decide both the property to contribute and the institutions to which the contributions would be made. But the direct tax benefit available to the donor would shift most, or all of the cost, of the gift to the Federal Government.

We believe there are sound policy reasons underlying the general rule that the deduction for gifts of ordinary income property should be limited to the taxpayer's basis in the property contributed. The bill would allocate resources to a particular form of education at a time of general fiscal restraints without a formal determination by Congress of whether this program is preferable to other worthy programs that cannot be funded.

Section 2 of the bill provides that taxpayers would be given a $100 tax credit for each postsecondary vocational training course taught by a qualified teaching employee of the taxpayer during the year. We likewise oppose section 2 of Senate bill 108. As in the case of section 1, section 2 would create a new subsidy for vocational education at a time when fiscal restraint requires cutbacks in spending. Congress should examine this proposal as it were to direct appropriation in aid of vocational education, both in terms of its efficiency and effectiveness in achieving its intended goal and in terms of its desirability vis-a-vis other worthy programs.

Senate bill 1464 exempts from the excess business holding provisions of the code certain divestitures by certain private foundations. In effect, Senate bill 1464 would permit a foundation meeting the specific conditions set forth in the bill to hold 100 percent of its interest in a hotel business indefinitely, notwithstanding the general limitations imposed by section 4943 on the business holdings of a private foundation.

We understand that Senate bill 1464 was intended primarily to allow the El Pomar Foundation to maintain its ownership in the stock of the corporation which owns the Broadmoor Hotel in Colorado Springs, Colo. We oppose Senate bill 1464. The concerns that led to the enactment of the excess business holdings rules are fully applicable to foundation holdings that would be exempt under this bill. Foundation ownership of 100 percent of a hotel business presents the potential for competitive advantage over hotel businesses owned by taxable persons, for the use of the foundation's assets for the benefit of private individuals, and for diversion of the foundation manager's time from the charitable activities of the organization to the business activity.

In addition to our general objection to exceptions to the excess business holdings rules, we are concerned about the equity of Senate bill 1464 in view of the fact that other foundations that owned businesses in 1969 when the provisions were enacted have been working to comply with the law by disposing of their excess business holdings. It seems to us it would be unfair to the foundations which have made dispositions in compliance with the rules to provide a special exemption for foundations which have not complied.

We think that the excess business holdings rules are sound and should continue to be applied equally to all foundations.

Senate bill 1549 provides an exemption from the tax on unrelated business income for schools and pension trusts who have invested as limited partners in partnerships holding working interests in domestic oil and gas wells. The bill also would exempt from the debt-financed property rules a pension trust's or an educational institution's share of a limited partnership's income from the same kind of investments, namely, working interests in domestic oil and gas wells. We oppose S. 1549.

The exemption provided by the bill would apply only to income from working interests in oil and gas wells received by pension trusts and schools. However, the rationale given for granting the exemption is that the investment through a limited partnership is passive in nature and, therefore, should not be subject to the unrelated business income tax. This rationale, if adopted, would apply equally to investments in any active business by any tax-exempt organization as long as the investment was made through a limited partnership. Therefore, adoption of this legislation could be expected to lead to repeal of the unrelated business income tax for any investment through a limited partnership. Exemption from the unrelated business income tax of investments made through limited partnerships would be inconsistent, in our judgment, with the purpose for which this tax was enacted. Placing investments in active businesses in a limited partnership does not eliminate the primary problem—unfair competition—at which the unrelated business income tax is directed. The competitive advantages available to a business owned by a tax-exempt entity arise from the fact that the tax-exempt owner does not pay any tax on the income received. This same concern would be applicable to an investment in a limited partnership.

The exemption from the unrelated business income tax for rents, royalties, dividends, and interest was provided because, in addition to being passive, historically those were the investments that were recognized as proper for educational and charitable organizations because they appeared as not being likely to result in serious new competition for taxable business having similar income.

We are also concerned that investments by tax-exempt entities and limited partnerships engaged in active businesses may be used to benefit taxable persons in ways other than by the transfer of tax benefits. Participation in an active business provides numerous opportunities for subtle forms of self-dealing. In addition, we are concerned that the removal of the unrelated business income tax on income from a limited partnership interest would give tax-exempt organizations an incentive to solicit and accept gifts of crossover tax shelter interests which would provide additional tax advantages to the taxable investors who make those gifts.

Finally, even if a limited partnership interest in working interests in oil and gas wells were to be exempt from the tax on unrelated business income, we see no justification for exempting debt-financed investments in such property from the debt-financed property rules. The debt-financed property rules were intended to prevent use of tax exemptions for the benefit of taxable persons, and we believe those rules should continue to apply in this case. For the reasons above, we oppose Senate bill 1549.

Mr. Chairman, this concludes my testimony. I am sorry to be here and spoil Colorado Day. I do appreciate the opportunity of offering our views. I will be happy to try to answer your questions.

[The prepared statement of Hon. Ronald Pearlman follows:]

For Release Upon Delivery
Expected at 9:30 a.m., EDT
August 1, 1983

STATEMENT OF
RONALD A. PEARLMAN
DEPUTY ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
OF THE
SENATE COMMITTEE ON FINANCE

Mr. Chairman and Members of the Subcommittee:

I am pleased to present the views of the Treasury Department on the following bills:

S. 1600, which would adjust for inflation the income tax basis of common stock and real property for purposes of determining capital gains;

S. 1579, which would increase the mileage allowance for charitable deduction purposes to the level allowed for business expense deduction purposes;

S. 108, which would provide new tax incentives for postsecondary vocational education programs;

S. 1464, which would provide an exemption from the excess business holdings divestiture requirements for certain private foundations holding stock in corporations operating hotel businesses; and

S. 1549, which would provide an exemption from the unrelated business income tax for income received by individual retirement accounts, qualified retirement trusts, and certain educational organizations from investments as limited partners in limited partnerships holding working interests in oil and gas properties.

I will discuss each of these bills in turn.

S. 1600
Indexing the Basis of Certain Capital Assets

Background

Inflation is a general increase in the price of goods and services. During inflationary periods, assets that increase in dollar value may experience no increase, or even a decrease, in real value. The tax law, however, determines taxable income without a direct adjustment for the effects of inflation on the real purchasing power of assets. It treats as gain on the sale of an asset the entire increase in the dollar value of the asset over the period the asset was held, even though much of the increase may be attributable to inflation and may not represent a real increase in wealth.

Current law contains several provisions that may be regarded as efforts to compensate for the failure to adjust taxable income for inflation. Non-corporate taxpayers are permitted to exclude 60% of net capital gains from taxable income, and corporate taxpayers can use an alternative tax rate of 28% on their net capital gains. The preferential treatment of net capital gains has the effect of offsetting the overstatement of gain that results from inflation. In a given case, however, the offset may overcompensate or undercompensate for inflation depending on the real return on the asset, how long the asset was held, and the rate of inflation while the asset was held. Similarly, the accelerated cost recovery system (ACRS) enacted in the Economic Recovery Tax Act of 1981 (ERTA) has the effect of making the value of depreciation deductions less sensitive to inflation. Finally, taxpayers are entitled to account for inventories under a last-in, first-out (LIFO) method that in effect adjusts for inflation on income attributable to sales of business inventory.

ERTA also provided for the indexing of the tax rate brackets for inflation starting in 1985. It is important to distinguish "bracket creep," the problem addressed by rate indexing, from the problem of mismeasurement of income caused by inflation. As inflation reduces the value of the dollar, a taxpayer experiencing no growth in real income from year to year will find his dollar income increasing. As a result, his income is taxed in higher tax brackets even though his real income has not increased. This automatic increase in taxes as a result of inflation is referred to as "bracket creep" and will be largely eliminated after 1984 by the indexing provision enacted in ERTA. This provision, however, does not have any effect on the problem of inflationary overstatement of gains on the sale of property. When inflationary increases in the dollar value of property are treated as taxable income, the taxpayer's income is measured incorrectly. Adjustments in the tax rate schedule do not, and cannot, address this income mismeasurement problem.

Description of S. 1600

S. 1600 would add to the Internal Revenue Code a new provision designed to prevent inflationary increases in the dollar value of certain qualifying property from being subject to capital gains tax. Under the bill, only common stock and real property (excluding stock and real property which is inventory or held primarily for sale to customers in the ordinary course of the taxpayer's trade or business) would qualify for inflation indexing. Tangible personal property would not be subject to indexing and stock of a foreign corporation would not qualify unless traded on a U.S. exchange.

The bill uses the gross national product deflator as the measure of inflation. Indexing would be effected by increasing the tax basis of an asset at the time of disposition proportionately to the ratio of the deflator in the quarter in which taxpayer disposes of the asset to that in the quarter in which the asset was acquired. The provision cannot increase taxable capital gains, as compared with current law, as the bill would not require decreases in basis if the gross national product deflator declined. The bill provides that only increases in the deflator from the last quarter of calendar year 1984 would be taken into account, but we understand that the intent is to start with the fourth quarter of 1983.

The inflation adjustment for qualifying assets owned by partnerships and S corporations would pass through to the owners of equity interests in the entities. Interests in regulated investment companies, real estate investment trusts, and common trust funds would be indexed only to the extent that the entities hold qualifying stock and real property. The bill contains numerous provisions intended to prevent manipulation of the inflation adjustment in a variety of cases.

Discussion

Although we recognize that an argument can be made for exempting inflationary gains from income tax, we must oppose the bill. Our opposition is based on three major concerns: first, the limited approach to inflation indexation in the bill would create unacceptable economic distortions; second, the bill would cause an unacceptable level of additional complexity in the tax law; and third, the bill would duplicate the effect of provisions in current law that indirectly adjust for inflation.

Economic Distortions

S. 1600 is a limited proposal that indexes only certain assets at certain times for certain purposes. Such partial indexing necessarily would create inconsistencies between the tax treatment of indexed and non-indexed assets. These inconsistencies would cause economic distortions. S. 1600 also would add new complexity in the tax law. The cumulative effect of the damage to the economy from these distortions and the damage to the tax system from this complexity would outweigh the benefits from proper inflation accounting for the transactions covered by the bill.

S. 1600 indexes common stock and real property but no other property. Bonds, tangible personal property, and all other property would be subject to taxation without regard to inflation. However, the measurement of gain or loss on the disposition of these other types of property is affected by inflation just as much as the gain or loss on common stock and real property. As a result, the bill would provide a substantial new incentive to own common stock and real property instead of other types of investments. The only way to prevent this incentive would be to index all assets.

Additionally, because of the favorable treatment of common stock, the bill would create an incentive to incorporate assets that otherwise would not qualify for indexing. For example, an investor in paintings could transfer a painting to a corporation that owns no other asset, sell the stock of the corporation when he wishes to sell the painting, and secure an inflation adjustment for what is really an investment in a painting. Although the bill would exclude some obvious abuse cases from the benefits of indexing, there is no way to eliminate S. 1600's inherent bias in favor of incorporating assets.

The bill also introduces a mismeasurement of income when qualifying property is leveraged. A debtor benefits as inflation reduces the real burden of a fixed dollar value debt. This benefit to debtors represents economic income and would be taxed under a fully indexed system. A lender suffers a detriment as inflation reduces the value of repayments on the debt. This detriment represents economic loss that would be taken into account under a fully indexed system. Nevertheless, S. 1600 disregards the effect of inflation on borrowing. As a result, the borrowing and lending sides of a debt-financed acquisition of common stock or real property would be subject to different tax regimes.

Consider the following example. A taxpayer borrows 100% of the cost of a qualifying building for 15 years at a time when no inflation is anticipated. The only payments required over the term of the borrowing are interest payments. After 15 years, unanticipated inflation has caused the building to double in dollar value. The taxpayer sells the property for no real economic profit, using half of the sales proceeds to pay off the debt and retaining the other half. The borrower was not hurt by inflation since he had no equity investment in the building, and is able to retain cash due to his ability to pay off the debt with deflated dollars. The cash retained represents economic income. However, under the bill, no tax is owed by the borrower because the gain on the sale is attributable solely to inflation. Moreover, the lender would get no deduction for his corresponding economic loss.

S. 1600's failure to tax borrowers and to allow lenders deductions with respect to the inflation component of interest can only distort economic choices. Only by making indexing available to lenders and taxing borrowers on inflationary gains is it possible to eliminate the debt-related distortions that would otherwise result from S. 1600.

The bill would create a further incentive to "churn" depreciable real property investments so that the inflation adjustment can be converted into depreciation deductions. For example, assume that a taxpayer owns a depreciable building in which he has a small depreciable basis but which he could sell tax free with an inflation adjustment. He sells the building tax free and buys a similar building, with the result that the full price of the new building, including the inflation write-up, is depreciable. If he had retained the old building he could have depreciated only the old, small basis that reflected no inflation adjustment.

This example assumes that the taxpayer's depreciation deductions were equal to economic depreciation on the property. Under ACRS, a taxpayer could have depreciation deductions in excess of economic depreciation, so that gain would be recognized and a tax would be due on sale of the property. In those cases, the benefits of churning would be reduced. It is clear, however, that in many instances S. 1600 would create a substantial incentive to churn depreciable assets.

The bill does contain a provision denying the inflation adjustment in such a transaction when the principal purpose is to secure larger depreciation deductions. This rule, however, would not eliminate the incentive to dispose of depreciable real property. The rule would be virtually impossible to enforce in the cases to which it is intended to apply and would have no effect on those transactions that have a significant non-tax purpose -- even when increased depreciation deductions are a significant economic factor behind the transaction. The incentive to sell depreciable real property can be eliminated only by indexing depreciation deductions.

Complexity

S. 1600 is remarkably complicated. The best example of this is the bill's treatment of conduit entities -- regulated investment companies, real estate investment trusts, and common trust funds. The bill splits ownership interests in these entities into an indexed portion and a non-indexed portion, in proportion to the ratio of qualified stock and real property to other property held by the entity. This division is to be done each month. Consequently, if an investor in a mutual fund owning stocks and bonds sells his interest after owning it for 10 years, he would be required to make 120 separate inflation adjustments to determine his tax on the sale.

Other provisions in the bill are nearly as complicated. The inflation adjustment for assets held by partnerships must be allocated to the partners. This will require intricate allocation rules. Under the bill, if real property is improved or capital is contributed to a corporation, the improvement or contribution is indexed for inflation retroactively to the date of acquisition. To prevent potential abuse of this rule, the bill contains a provision for separate indexing of substantial improvements and contributions. This provision will necessarily involve complicated allocations and multiple inflation adjustments. Moreover, regulations would have to distinguish those improvements and contributions that are substantial from those that are not.

Intricate rules also will be required to distinguish qualified property from nonqualified property, including rules to distinguish a creditor's interest (which does not qualify) from other interests and rules to distinguish preferred stock from common stock.

Duplication of Inflation Allowances in Current Law

The distortions and complexity that would result from S. 1600 are particularly troubling since current law contains provisions that soften the effect of inflation in many of the same situations the bill addresses. The inflation adjustment in S. 1600 would duplicate the approximate inflation adjustment provided in current law by the preferential tax treatment of capital gains. Moreover, in the case of depreciable real property, the bill would duplicate to some extent the approximate inflation adjustment provided by ACRS.

In conclusion, the Treasury recognizes the important problem that inflation poses for our tax system. S. 1600 is an attempt to address part of that problem. Only a comprehensive solution to the inflation problem that indexes all assets and all liabilities for all purposes, including depreciation, can avoid the distortion and duplication inherent in a limited approach like that taken in S. 1600. Unfortunately, full indexation would substantially increase the complexity of the present income tax system, which is already criticized as being too complex. Consequently, we cannot recommend at this time indexing of basis as a solution to the problem of income mismeasurement resulting from inflation.

I should emphasize that our objections to S. 1600 in no way apply to the rules enacted in ERTA to index the tax brackets. The ERTA rules apply across the board and therefore will not distort economic decisions. Bracket indexing is simple, as it merely requires the IRS to make changes in the tax tables. The ERTA rules are sound fiscal policy, since they prevent inflation from causing automatic tax increases without an act of Congress. Finally, rate indexing is fair, as it prevents the erosion of the progressive rate schedule that otherwise would result from inflation.

S. 1579
Increase in Standard Mileage Rate for Purposes of Computing Charitable Contribution Deduction

Background

At present, the rate taxpayers are permitted to use for computing the cost of the use of an automobile for purposes of the business expense deduction is 20 cents per mile. Taxpayers who use an automobile in connection with performing services for charitable organizations may use a standard mileage rate of nine cents a mile in computing their charitable contribution deduction. Nine cents also is the mileage rate used for determining the medical and moving expense deductions. The difference in the two mileage rates results from the fact that the standard mileage rate permitted for purposes of the charitable contribution deduction (as well as the medical and moving expense deductions) reflects an allowance for gas and oil, that is, the expenses directly incurred in performing the charitable service (or in obtaining medical care or in moving). On the other hand, the standard mileage rate for business use of an automobile reflects an additional allowance for depreciation, insurance, general repairs and maintenance, and registration fees.

Description of S. 1579

S. 1579 would amend section 170 of the Internal Revenue Code to provide that the amount of the charitable contribution deduction allowable for expenses incurred in the operation of an automobile in performing services for a charitable organization shall be determined at the same mileage rate used to compute business expense deductions.

Discussion

We acknowledge that a reasonable argument can be made for using the same mileage rate to measure the cost of using an automobile for charitable purposes as is used to measure the cost of using an automobile for business purposes. Nevertheless, we believe that there are sound reasons for the different rates used under present law. Accordingly, the Treasury Department must oppose S. 1579.

Allowance of the lower mileage rate for purposes of the charitable contribution deduction reflects the longstanding administrative position that the only deductible expenses are those directly attributable to the use of a vehicle in rendering charitable services. No deduction is allowed for a proportionate share of general maintenance, general repairs, depreciation, or fixed costs, such as insurance or registration fees. There are three reasons for this position.

First, section 170 of the Code requires that a contribution be paid to or for the use of a qualifying charity to be deductible. Fixed or general expenditures which would have been incurred regardless of the use of a vehicle for charitable purposes cannot be said to be amounts paid to or for the use of a charitable organization. Second, it is difficult to identify and quantify the amount of indirect costs that are properly attributable to charitable endeavors. Third, it is difficult to ensure compliance in this area under current rules, and to allow a deduction for these indirect costs would exacerbate this problem.

I would also note that the rationale underlying these limitations applies not only to the use of a personal automobile, but also to other property (such as the rent-free use of nonbusiness real estate) used for both personal and charitable purposes. Thus, in all cases, fixed costs, such as depreciation, insurance, and general maintenance and repairs, may not be deducted. If such costs are allowed for the use of automobiles, it will be argued that they also should be allowed for the use of other property. Such an expansion of the existing rules would compound problems of measurement and compliance.

We believe that the current rules provide a proper measure of the charitable deduction for the use of a taxpayer's automobile. In most cases, the current mileage rate is adequate to cover the incremental costs directly attributable to rendering a charitable service. Moreover, taxpayers are not limited to the standard mileage rate, but may deduct their actual expenses for gas and oil if that alternative is more favorable. Thus, the current mileage rate should not work a hardship on any taxpayer whose actual out-of-pocket costs exceed the mileage allowance.

S. 108
Tax Incentives for Postsecondary Vocational Education Programs

Section 1: Increased Deduction for Charitable Gifts of Property Used in Vocational Education Programs

Background

Under current law, a corporation may deduct, within certain limits, the amount of cash or other property contributed to qualified charitable organizations. Limitations are imposed, however, with respect to contributions of property which, if sold, would yield ordinary income. In the case of contributions of inventory, for example, the deduction is limited to the taxpayer's basis in the property. In the case of contributions of property used in a taxpayer's trade or business, the allowable deduction is generally the fair market value of the donated property reduced by the amount of any depreciation which would be recaptured as ordinary income if the taxpayer sold the property.

There are currently two exceptions to the general rule applicable to gifts of ordinary income property. The first exception applies to gifts by corporations (other than S corporations) of inventory, depreciable property and business real property to be used for the care of the ill, the needy or infants. The second exception involves gifts by corporations (other than S corporations, personal holding companies and certain service companies) of scientific equipment which is of an inventory nature to colleges and universities for research and experimentation. In both cases, the amount of the deduction is equal to the taxpayer's basis in the property plus one-half of the unrealized appreciation, not to exceed twice the taxpayer's basis in such property. With respect to the first exception, where depreciable property is contributed, no deduction is allowed for any amount which would be subject to the various recapture provisions of the Code.

Description of Provision

Section 1 of S. 108 would allow any taxpayer a larger deduction for gifts of tangible personal property to a public community college or public technical institute or any other institution of higher education if substantially all of the use of the property by the donee is for training students enrolled in a postsecondary vocational education program. If all the conditions of the bill are satisfied, the amount of the allowable deduction would be the taxpayer's basis in the property plus one-half the unrealized appreciation in the property. However, in no event would the deduction exceed twice the taxpayer's basis in the property contributed. Unlike the special rule for gifts of depreciable property for the care of the ill, the needy or infants, no limitation is placed on the deduction for amounts subject to recapture.

Discussion

The Treasury is opposed to section 1 of S. 108.

The bill would create a new open-ended Federal program, funded by the Treasury but administered by private taxpayers, to place equipment in schools for use in postsecondary vocational education programs. The donor would decide both the property to contribute and the institutions to which the contributions would be made, but the direct tax benefits available to the donor would shift most or all of the cost of the gift to the Federal government. For example, if a taxpayer contributes inventory property which cost $1,000 to produce and which is worth $3,000, the taxpayer would be entitled to a deduction of $2,000. This would produce a tax benefit of $1,000 for a taxpayer in the 50% bracket. Thus, in effect, the govenment would be purchasing the equipment at cost for use by the institution of the donor's choice.

We believe there are sound policy reasons underlying the general rule that the deduction for gifts of ordinary income property should be limited to the taxpayer's basis in the property. This general rule produces the same tax benefit to the donor as if he sold the property and contributed the proceeds to charity and ensures that there is some charity in charitable giving because the taxpayer will bear a significant portion of the cost of making the gift.

Furthermore, the bill would allocate resources to a particular form of education at a time of general fiscal restraint, without a formal determination of whether this program is preferable to other worthy programs that cannot be funded. Increasing the quantity of equipment available in postsecondary vocational education programs may be a worthy goal. However, since taxpayers ultimately will bear almost all of the cost of funding this program, we believe its desirability and effectiveness should be judged in the same manner as a direct appropriation for such a program. In this regard, we do not believe that Congress would pass an unlimited appropriation for an equipment contribution program to be administered by private taxpayers with only limited review by the IRS long after the contributions are made.

We also foresee serious difficulties in administering the provisions contained in the bill. A significant potential for abuse lies in the fact that the amount of the deduction depends in large measure on the fair market value of the property. Fair market value may be difficult to determine if the donated property is not selling well in the current economic climate or where technological advances have reduced its value. Moreover, the bill does not specify whether the wholesale or retail market is the appropriate measure of fair market value. If the government were to purchase directly the volume of equipment which we may contemplate will be contributed under this bill, it undoubtedly would be entitled to a wholesale price. Thus, the wholesale price would be the most appropriate measure of fair market value.

Additionally, we have a technical objection to section 1 of S. 108, relating to gifts of depreciable property used in a taxpayer's trade or business. As currently drafted, the bill would permit taxpayers to deduct amounts which would be subject to recapture if the property were sold. In this respect, the bill is more generous than the existing provision providing special treatment for charitable gifts for the care of the ill, the needy or infants. Such special treatment is completely unjustified. For instance, the depreciation recapture provision only becomes relevant when a taxpayer has deducted an amount as depreciation which exceeds the property's actual economic depreciation. Since the taxpayer has had the benefit of this excess deduction, it is appropriate to recapture the benefit when the taxpayer disposes of the property. Reducing the amount of the deduction for a charitable disposition of property by the amount of this benefit produces the same result as recapture. We believe this is the correct result.

Section 2: Postsecondary Vocational Education Instruction Credit

Description of Provision

Section 2 of S. 108 would give taxpayers a $100 tax credit for each postsecondary vocational training course taught by a qualified teaching employee of the taxpayer during the taxable year. However, a taxpayer may claim the credit for only five courses taught by the same employee. In addition, taxpayers would be permitted a $100 tax credit for their employment of any qualified vocational education instructor from a college, technical institute or university on a temporary basis. The amount of the credit is not to exceed the taxpayer's tax liability for the year reduced by allowable credits against tax other than withholding taxes, the gasoline and fuel credit, and the earned income credit.

For purposes of the bill, a "qualified vocational education instructor" means an individual who is employed by the taxpayer on a full-time basis for at least three months, but not more than a year, and who both prior to such employment and at the end of the year for which the credit is claimed was a full-time postsecondary vocational education instructor. A "qualified teaching employee" is a full-time employee of the taxpayer who taught at least one postsecondary vocational education course on a part-time basis during the taxable year at an institution of higher education without compensation by such institution and who was not a qualified vocational education instructor at any time during the taxable year.

Discussion

The Treasury Department is opposed to section 2 of S. 108.

As in the case of section 1 of the bill, section 2 would create a new subsidy for vocational education at a time when fiscal restraint requires cutbacks in spending. Congress should examine this proposed new subsidy as it would a direct appropriation in aid of vocational education both in terms of its efficiency and effectiveness in achieving its intended goal and in terms of its desirability vis-a-vis other worthy programs.

In this regard, we question the efficiency and effectiveness of the bill. It is doubtful that making a credit available to an employer will encourage an employee to devote additional time to teaching a course without additional compensation and a $100 credit is probably not generous enough to make an employer whole for loss of the employee's productive time. We would submit that, because of these facts and the fact that the credit is not incremental, the proposal will probably result in merely rewarding taxpayers' current practices rather than encouraging an expansion of those practices.

Finally, although section 2 is carefully drafted to limit any potential for abuse, we believe that potential abuses would still exist. A number of the factors upon which eligibility for the credit depends may be difficult to verify. For instance, it may be difficult to determine whether a particular course taught by a taxpayer's employee is a "postsecondary vocational education course" within the meaning of the bill, or whether the employee was compensated for teaching the course.

S. 1464

Exemption from Excess Business Holdings Divestiture Requirements for Certain Private Foundations

Background

As part of the Tax Reform Act of 1969, Congress imposed a number of restrictions on private foundations. These restrictions were, in large part, a response to problems described in the 1965 Treasury Department Report on Private Foundations. This Report concluded that charitable assets were being used to a substantial extent for noncharitable purposes. These noncharitable uses included self-dealing between foundations and donors, undue delay in the delivery of benefits to charity, extensive foundation involvement in business resulting in noncharitable use of charitable assets, family use of foundations to control corporate and other property, and financial transactions unrelated to charitable functions.

One significant area of abuse that was highlighted in the 1965 Treasury Report was the ownership of active business enterprises by foundations. Extensive private foundation ownership of businesses raised a number of problems. A business that is owned by a tax-exempt entity often has a competitive advantage over a similar business owned by taxable persons. Changes made in 1969 in the taxation of unrelated business income removed many potential competitive advantages for businesses owned by tax-exempt entities. Congress decided, however, that these changes did not eliminate all of the concerns that had been raised in connection with foundation ownership of active businesses. For example, the rate of return that a tax-exempt entity must demand from its investment in a business may be lower than the rate of return that a taxable investor would demand. A private foundation, which receives dividends from the business and income from other investments tax-free and which also receives tax deductible contributions, has a greater ability to allow the business to retain earnings than other business owners. The 1965 Treasury Report noted a common willingness of foundations to defer indefinitely the realization of profits from investments in commercial operations. Such deferral not only provides a competitive advantage to the business, but also results in deferral of distributions to the charitable beneficiaries of the foundation.

Another problem described in the 1965 Treasury Report with respect to foundation control of a business enterprise is that control provides such a broad spectrum of opportunities for the foundation's assets to be used for the benefit of private individuals that it is impossible to prohibit many potential acts of self-dealing. For example, a business acquaintance of the donor may be accommodated in the structuring of transactions with the foundation-controlled business. It would be impossible in many cases to determine the existence of such an accommodation.

Finally, the 1965 Treasury Report pointed out that substantial ownership of a business by a private foundation may be detrimental to charity because the attention of the foundation's managers may be drawn away from charitable pursuits. When a foundation owns a substantial portion of a business, it is incumbent upon the foundation managers to ensure that its investment in the business is being managed properly and that the business is as successful as possible. Thus, even where the actual management of the business is the responsibility of individuals who are unrelated to the foundation, the foundation managers are obliged to be informed about and responsive to the condition of the business. The demands that ownership of a business impose on the foundation managers' time reduces the time and attention the foundation managers can devote to their charitable duties. Where the investment of a foundation in a business is substantial, the foundation managers' primary concern may become the welfare of the business. As explained in the 1965 Treasury Report, this distraction of foundation managers from charitable activities eliminates one of the factors -- concentration of the energies and experience of donors on accomplishing charitable works -- that makes private foundations of unique value to philanthropy.

The 1965 Treasury Report provides a number of actual examples of the problems described above relating to foundation ownership of businesses. In recognition of these problems, Congress in 1969 enacted Code section 4943, which prohibits foundations, alone or in combination with certain related persons, from owning substantial portions of any active business enterprise. Transition periods of up to 20 years were provided to allow for initial dispositions by foundations having substantial holdings in 1969, with an additional 15-year period provided before final dispositions must be made. The penalty for owning business holdings in excess of the permitted amounts is an excise tax on the foundation.

Description of S. 1464

S. 1464 would exempt certain excess business holdings from the divestiture requirements of section 4943. This exemption would apply to stock of a corporation held by a private foundation if the foundation and the corporation satisfy the following conditions:

(1) On May 26, 1969, the private foundation owned 100 percent of the voting stock in the corporation;

(2) The voting stock of the corporation was acquired by the foundation solely by gift, devise, or bequest before December 31, 1966;

(3) Neither the donor of the stock of the corporation nor any member of his family is a foundation manager of the foundation on or after December 31, 1956;

(4) On May 26, 1969, and at all times thereafter substantially all of the operating assets of the corporation were used in operating a hotel business enterprise; and

(5) On May 26, 1969, and at all times thereafter the hotel business enterprise conducted by the corporation is of substantially the same character as the enterprise that was conducted by the corporation on the date of the last gift, devise, or bequest of stock of the corporation to the foundation.

Discussion

In effect, S. 1464 would permit a foundation meeting the conditions set forth in the bill to hold its 100 percent interest in a hotel business indefinitely, notwithstanding the general limitations on business ownership applicable to all other private foundations. We understand that S. 1464 is intended primarily to allow the El Pomar Foundation to maintain its ownership of the stock of the corporation which owns the Broadmoor Hotel in Colorado Springs, Colorado. The bill also may apply to other foundations.

The Treasury Department opposes S. 1464.

The concerns that led to enactment of the excess business holdings rules are fully applicable to foundation holdings that would be exempted from these rules by S. 1464. Foundation ownership of 100 percent of a hotel business presents the potential for competitive advantage over hotel businesses owned by taxable persons, for use of the foundation's assets for the benefit of private individuals, and for diversion of the foundation managers' attention from the charitable activities of the foundation.

The argument has been made that the excess business holdings rules are not necessary because the prohibition on self-dealing and the minimum distribution requirement are sufficient to prevent abuses involving foundation-owned businesses. We do not consider these other rules to be sufficient to eliminate the problems associated with foundation ownership of businesses. The self-dealing rules prohibit a specific list of transactions with disqualified persons. The possibilities for conferring private benefit through a controlled business are numerous and in many cases very subtle. We do not believe it is possible to draft a statutory prohibition of all possible acts of self-dealing involving a foundation-controlled business. Even if all possible transactions could be identified, the prohibition of all such transactions would interfere unreasonably with operation of the business. In addition, administration of such a prohibition would be virtually impossible.

With respect to the potential for competitive advantage and delays in the delivery of benefits to charity, we do not consider the minimum distribution requirement to be an effective safeguard where a foundation owns a substantial interest in a business enterprise. It is very difficult in many cases to value a closely held business. Since the minimum distribution requirement depends on the value of the foundation's investment assets, the lack of an accurate valuation substantially undermines the effectiveness of the requirement. Even where valuation is not a problem, the minimum distribution requirement does not prevent improper deferral of benefits to charity. As discussed above, the minimum distribution requirement has been set at 5 percent to permit foundations to preserve corpus in times of inflation. Many investments a foundation might make earn substantially more than a 5 percent rate of return. The result is that a foundation can receive a negligible return from one investment, such as a controlled business, and still be able to satisfy its minimum distribution requirement out of income from other investments. Even if a foundation's only investment is in the business, the 5 percent distribution requirement would permit the foundation to accept a 5 percent return, which will be a relatively low rate of return at times, while allowing the remainder of the earnings to accumulate in the business. For these reasons, we do not consider the minimum distribution requirement sufficient to ensure that the benefits of an investment of charitable funds are reserved for and promptly delivered to charity when the investment is in the form of substantial ownership of an active business.

Another argument that has been made to support special exceptions to the excess business holdings rules is that certain foundations should be allowed to retain control of a particular business because no buyer would continue to operate the business in the same manner in which, or at the same location as, it is operated by the foundation. These foundations argue that the business they operate provides special benefits to the community, for example employment opportunities or continuation of a particular type of business that is disappearing under pressures of modernization, which justify continued ownership by the foundation. Rather than reducing our concerns about foundation ownership of businesses, this argument appears to us to present an example of the adverse effects that business involvement can have on the charitable efforts of foundation managers. If operation of a business is substantially related to a charitable purpose, then holdings in the business would not constitute excess business holdings. The fact that no taxable investor would continue the business operation in its present form indicates strongly that the current method of operation is an inefficient use of the property that does not produce the greatest benefits to charity. Therefore, foundations using this argument essentially are asking Congress to condone the use of charitable assets to continue in operation an inefficient business that does not serve solely charitable purposes.

In addition to our general objections to exceptions to the excess business holdings rules, we are concerned about the equity of S. 1464 in view of the fact that other foundations that owned businesses in 1969 have been working to comply with the law by disposing of their excess business holdings. It would be unfair to the foundations which have made dispositions in compliance with the rules to provide special exemptions for foundations which have not complied.

In summary, we believe the excess business holdings rules are sound and should continue to be applied equally to all foundations. Moreover, a foundation such as the El Pomar Foundation has been given until 1989 to reduce its 100 percent holdings in a business to 50 percent and until 2004 to reduce its ownership to 35 percent (assuming no stock is acquired by certain related persons). These extended periods are sufficient to permit orderly dispositions. For the reasons discussed above, we oppose the legislative exception provided by S. 1464.

S. 1549

Exemption from Tax on Unrelated Business Income for Investments by Schools and Pension Trusts in Working Interests in Oil and Gas Wells

Background

Generally, tax-exempt organizations are not taxed on income earned on investments. However, in order to prevent exempt organizations engaged in commercial activities from having a competitive advantage over taxable entities similarly engaged, a tax is imposed on income earned by an exempt organization from business activities that are unrelated to its exempt purposes. Exemptions from the tax on unrelated business income are provided for rents, royalties, dividends, and interest. The pertinent legislative history shows that the reason for exempting these particular types of income from the tax on unrelated business income was that --

> they are "passive" in character and are not likely to result in serious competition for taxable businesses having similar income. Moreover, investment-producing incomes of these types have long been recognized as a proper source of revenue for educational and charitable organizations and trusts.

S. Rep. No. 2375, 81st Cong., 2d Sess. 30-31 (1950).

Rents, royalties, dividends, and interest are not exempt from the unrelated business income tax if they are derived from property that is acquired or improved with borrowed funds. Subject to limited exceptions, a share of any income from debt-financed property, proportional to the ratio of debt on the property to the adjusted basis of the property, is treated as income from an unrelated trade or business.

The original rules relating to debt-financed property were developed in response to abusive sale-leaseback transactions between tax-exempt organizations and taxable owners of active businesses. These transactions typically involved a tax-exempt organization's purchase of an active business, financed primarily by a contingent, nonrecourse note, followed by a lease of the assets of the business to the seller. The effect of these transactions was to convert the ordinary income of the business into capital gains for the seller while allowing the tax-exempt organization eventually to acquire property with little or no investment of its own funds. The primary objection to sale-leaseback arrangements involving borrowed funds was that they permitted an organization's tax exemption to benefit the taxable seller, either by conversion of ordinary income to capital gain or by payment of a higher price for the property than a taxable purchaser would pay.

Unfortunately, enactment in 1950 of a tax on income from certain leases was insufficient to prevent abuse because new forms of transactions involving leveraged investments quickly developed. In response to these new transactions, the provision was strengthened in 1969 by subjecting to the unrelated business income tax the income received from all kinds of debt-financed property. This broad revision reflected concern not only with existing sale-leaseback transactions, but with the possibility of other abusive uses of leveraged investments by tax-exempt organizations.

Description of S. 1549

S. 1549 would provide an exemption from the tax on unrelated business income for income received by pension trusts and educational organizations from investments as limited partners in partnerships holding working interests in domestic oil and gas wells. This exemption would not apply if the general partner of the limited partnership were related to one or more of the tax-exempt limited partners. In addition, the exemption would not apply to income allocated to a limited partner during a partnership year in which allocations of deductions, losses, credits, and cash distributions were not consistent with allocations of income or gain. Use of multi-tier partnerships or other arrangements for the principal purpose of avoiding these limitations on allocations would be prohibited. The limitations would not apply to allocations of depreciation, depletion, or gain or loss with respect to property contributed to a partnership which are made, in accordance with section 704(c)(2), on a nondiscriminatory basis between exempt and nonexempt limited partners.

The bill also would exempt from the debt-financed property rules a pension trust's or educational institution's share of a limited partnership's income from working interests in domestic oil and gas wells unless--

(1) the acquisition price of the working interest is not a fixed amount determined as of the date of acquisition;

(2) the amount of indebtedness incurred in acquiring, developing or operating the working interest or any other amount payable with respect to such indebtedness, or the time for making any payment of any such amount, is dependent, in whole or in part, upon any revenue, income, or profits derived by or from such limited partnership;

(3) the working interest is at any time after its acquisition leased by the limited partnership to the person who sold it to the limited partnership or to certain persons related to the seller;

(4) the working interest is acquired from, or at any time after the acquisition is leased by the limited partnership to, certain persons related to the pension trust or educational organization; or

(5) the seller of the working interest, certain persons related to the seller, or certain persons related to the pension trust or educational organization provide the limited partnership, the pension trust, or the educational organization with nonrecourse financing in connection with the purchase of the working interest and such financing is subordinate to any other debt on the property or bears interest at a rate which is significantly lower than the rate otherwise available.

However, the last three of these restrictions would not apply to any acquisition, lease, farmout, or other transfer of working interests to a person related to the general partner, provided the terms of such transfer are consistent with the terms of similar transfers in the geographic area.

Discussion

The Treasury Department opposes S. 1549.

The exemption provided by S. 1549 would apply only to income from working interests in oil and gas wells received by pension trusts and schools. However, the rationale given for granting the exemption is that investment through a limited partnership is "passive" in nature and therefore should not be subject to the unrelated business income tax. This rationale would apply equally to investments in any active business by any tax-exempt organization as long as the investment was made through a limited partnership. Therefore, adoption of this legislation can be expected to lead to repeal of the unrelated business income tax for any investment through a limited partnership. Exemption from the unrelated business income tax of investments made through limited partnerships would be inconsistent with the purpose for which the tax was enacted.

Placing investments in active businesses in a limited partnership does not eliminate the primary problem -- unfair competition -- to which the unrelated business income tax is directed. The competitive advantages available to a business owned by a tax-exempt entity arise from the fact that the tax-exempt owner does not pay tax on the income received from its equity investment in the business. While the degree to which the tax-exempt organization is involved in the active management of the business may affect whether the attention of the managers of the tax-exempt organization is diverted from exempt activities, it is not relevant to the issue of whether the business obtains a competitive advantage because of its tax-exempt ownership.

The exemption from the unrelated business income tax for rents, royalties, dividends, and interest was provided because, in addition to being "passive," investments producing these types of income had long been recognized as proper for educational and charitable organizations and because they did not appear likely to result in serious new competition for taxable businesses having similar income. Thus, the "passive" nature of investments made through limited partnerships is not sufficient to justify an exemption from the unrelated business income tax.

Even if the "passive" nature of an investment were sufficient to justify exemption from the unrelated business income tax, limited partners are not necessarily "passive" investors. For example, under the 1976 Uniform Limited Partnership Act, a limited partner is permitted to engage in a number of activities without being considered to have participated in control of a business. These permitted activities include, among others, consulting with and advising a general partner with respect to the business of the limited partnership and voting on the removal of a general partner. Clearly, limited partners that can consult with and advise a general partner on business matters and can remove the general partner may have substantial active involvement in the business of the limited partnership.

In addition to our objections to providing a competitive advantage to an active business by allowing tax-exempt ownership through a limited partnership, we are concerned that partnership allocations may be used to transfer tax benefits from tax-exempt partners to taxable partners. We do not believe that the limitations on allocations contained in S. 1549 are sufficient to prevent such abuse. Rather, these limitations merely elevate the level of sophistication required to attain the desired results.

The allocation provisions of the bill contain certain technical deficiencies. For example, the bill does not require that allocations of basis be consistent with allocations of income or gain. Since the depletion deduction with respect to an oil or gas property and gain or loss on the disposition of such property are computed at the partner level rather than the partnership level, allocation of basis to taxable partners may have the effect of allocating depletion deductions to taxable partners while allocating gain to tax-exempt partners. Similarly, the allocation rules in the bill do not prohibit the allocation of capital gain to the taxable partners and ordinary income to the tax-exempt partners, nor do they prevent distribution schemes under which tax-exempt partners receive property on which there is substantial unrealized gain while taxable partners receive property on which there is little or no unrealized gain.

In addition, the bill fails to preclude potential abuse through the use of partnership "flip-flops." Although the bill attempts to insure that in each partnership taxable year the tax-exempt partner will be allocated no less a share of partnership loss, deduction, and credit than its share of partnership income and gain, it does not prevent the tax-exempt partner from having a disproportionately large share of all partnership items during partnership taxable years in which net taxable income is expected, and a disproportionately small share of all partnership items during partnership taxable years in which net losses are expected.

We also are concerned that investments by tax-exempt entities in limited partnerships engaged in active businesses may be used to benefit taxable persons in ways other than by the transfer of tax benefits. Participation in an active business provides numerous opportunities for subtle forms of self-dealing. For example, exploratory drilling conducted by a limited partnership on a tract of land can benefit owners of adjacent land. We see no justification for allowing tax-exempt income to be used to benefit taxable persons in this way. In addition, removal of the unrelated business income tax on income from limited partnership interests would give tax-exempt organizations an incentive to solicit and accept gifts of "cross over" tax shelters, which would provide additional tax advantages to the taxable investors who make the gifts.

Finally, even if limited partnership interests in working interests in oil and gas wells were to be exempt from the tax on unrelated business income, we see no justification for exempting debt-financed investments in such property from the debt-financed property rules. As I have explained, the debt-financed property rules were intended to prevent use of tax exemptions for the benefit of taxable persons. For several reasons, we do not believe the limitations on purchase price and financing provided in S. 1549 would prevent the abusive use of exemptions if debt-financed investments in working interests in oil and gas wells were not subject to the tax on unrelated business income.

One possibility for abuse exists because the restrictions on sale-leasebacks in the bill do not apply to sale-leasebacks between a limited partnership and a person related to the general partner. Thus, a tax-exempt organization could enter into a sale-leaseback with a taxable seller if the seller were a general partner and the terms of the sale and lease were consistent with the terms of similar transfers in the geographic area. Another possibility for benefit to a taxable person is that a tax-exempt organization may be willing to pay a higher price for the property than a taxable investor would, particularly since it could obtain nonrecourse financing from the seller. Finally, we are concerned that debt-financing would provide additional tax benefits that might be allocated unequally between taxable and nontaxable partners.

For the reasons described above, we oppose S. 1549.

This concludes my prepared testimony. I would be happy to answer your questions.

Senator ARMSTRONG. Well, Mr. Secretary, I thought maybe you had gotten up on the wrong side of the bed this morning when I heard you mention that you were here to oppose each of these wonderful bills.

Is this the first time that you have appeared before the committee?

Mr. PEARLMAN. It is, Mr. Chairman.

Senator ARMSTRONG. I am especially glad to welcome you.

Mr. PEARLMAN. Thank you.

Senator ARMSTRONG. Just to put your testimony in perspective, I was trying to reflect how often the Department has come up and testified in favor of proposed changes in the Tax Code, and I have been consulting the institutional memory here on the dais and they think that maybe only twice in recent years has the Department actually come forward to testify in support of any legislation. And so they tell me that I need not take your comments personally.

Mr. PEARLMAN. Certainly not.

Senator ARMSTRONG. And that I might even, in looking through your statement, particularly that portion of it in which you comment favorably upon indexing the personal tax rates, I might even recall that at one point the Department was less enthusiastic about that proposal than it is today. And so we are hopeful, as you have a chance to reflect on these issues, that maybe the Department will have a change of heart.

Mr. PEARLMAN. Mr. Chairman, one of your colleagues on this committee, a Senator from Missouri, when I discussed coming to Washington with him, said that one of the basic attributes that I would have to learn if I were to represent the Treasury is the ability to say no and to say it frequently.

Senator ARMSTRONG. You know, I think he advised me of the same thing when I joined the Senate Finance Committee. [Laughter.]

Mr. Secretary, I have several questions to ask you. However, I believe that you are also scheduled to testify this afternoon on another bill.

Mr. PEARLMAN. That's correct.

Senator ARMSTRONG. Would you like to submit your testimony on that at this time also in order to save coming back this afternoon?

Mr. PEARLMAN. Well, I would be happy to, except that the testimony is not quite prepared.

Senator ARMSTRONG. Fine.

Mr. PEARLMAN. We will be back this afternoon.

Senator ARMSTRONG. Let's deal then with the items which you have discussed this morning. And we are very grateful for your testimony, even though I personally may draw some different conclusions. I compliment you on a fine statement.

Mr. PEARLMAN. Thank you.

Senator ARMSTRONG. First of all, I want to ask about your observations on the indexing of the basis for capital gains. Is it the position of the Treasury Department that you would support this legislation if it was broader in scope? I notice that you emphasized that it was limited, which, of course, is correct.

Mr. PEARLMAN. Yes; we have another concern, which I think is probably shared by everyone, and that is the revenue impact of this bill, which we estimate over a 4-year period could be in excess of $2.5 billion, and obviously that revenue concern would be even greater in the event indexing were broader based.

I might point out that that revenue estimate, which is not precise, I recognize, did include the gain that would be anticipated from the arguable freeing up of capital assets. We did take that into consideration.

There is no question that the Treasury, and the administration, are concerned with the effects of inflation on the tax system. And, indeed, that is the reason that the administration is strongly committed to preserving the indexation of tax rates that currently is in the Code.

Certainly, Treasury would view a broad-based indexing concept seriously. I think there would be people within the administration, as I assume others, who would argue that broad-based indexing should really be part of an overall simplification project. If you get to a flat tax, if you get to a consumption-based tax with dramatically lower tax rates, it might be that the pressure of inflation on the system would be viewed as less. Certainly, one of the things that we would be most concerned about would be the revenue impact. And I would presume that if today we were sitting here with a bill that said let's index all assets, and we were looking at revenue estimates that were substantially in excess of the $2.5 billion plus that is estimated for this bill, we would probably have concern because of the revenue impact. But the concept is one that I think we certainly have sympathy for.

Senator ARMSTRONG. The $2.5 billion revenue figure which you have cited I take it is a netted figure.

Mr. PEARLMAN. It is a netted figure.

Senator ARMSTRONG. Is a larger number. Is the potential loss simply on a static basis?

Mr. PEARLMAN. Right.

Senator ARMSTRONG. And then some offsetting gain.

Mr. PEARLMAN. Correct.

Senator ARMSTRONG. Is that contained in your statement?

Mr. PEARLMAN. No; it is not in the statement. I have those numbers handwritten, but we will be happy to provide the revenue estimate to you.

Senator ARMSTRONG. I would be grateful if you would.

[The following was received for the record:]

pg 35

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

AUG 31 1983

Dear Senator Armstrong:

This letter is in response to your question to me at the hearings on August 1, 1983, about the revenue effect of S. 1600. As I indicated then, the Treasury revenue estimate did take account of the effects of induced additional realizations that we expect to occur as a result of the lowering of tax rates on realized capital gains provided by S. 1600.

The enclosed table shows the static effect (the reduction in revenue at levels of realizations projected under current law) and the induced effect (the increase in revenue due to increased realizations). The total revenue effect is the sum of the two separate effects. As can be seen from the table, induced realizations reduce the estimated revenue loss by about 40 percent, compared to the static estimate.

Please let us know if there is any further information or explanation we can supply.

Sincerely,

(signed) Ronald A. Pearlman

Ronald Pearlman
Deputy Assistant Secretary
(Tax Policy)

The Honorable
William L. Armstrong
United States Senate
Washington, D.C. 20510

Enclosure

Change in Fiscal Year Receipts due to Indexing the Basis for Long Term Capital Gains and Losses for Inflation after 1983
($ millions)

	1984	1985	1986	1987	1988
Static effect	*	-322	-889	-1,419	-1,968
Induced effect	*	125	354	573	806
Total change in fiscal year receipts	*	-197	-535	-846	-1,162

*less than $500,000.

Office of the Secretary of the Treasury
Office of Tax Analysis

July 29, 1983

Senator **Armstrong**. And I wonder if we could also have for the record the Treasury's estimate of the potential loss arising from the reduction in capital gains rates, and also the actual results that have been realized. I think that would be useful. But the main thing that I was trying to find out in looking at that $2.5 billion, is the $2.5 billion a fairly small remainder, or is that most of the static loss and very little offset?

Mr. **Pearlman**. Senator, I simply don't have that detail. But, again, I will be happy to try to provide that figure.

Senator **Armstrong**. We will sure take a look at that.

Mr. **Pearlman**. All right.

[The following was received for the record:]

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

DEPUTY ASSISTANT SECRETARY

AUG 31 1983

Dear Senator Armstrong:

This letter is in response to the question you raised during the August 1 hearing held by the Subcommittee on Taxation and Debt Management on S. 1579 concerning when the mileage allowance for charitable deduction purposes was last increased.

The current allowance of nine cents per mile was established in 1980 effective for transportation expenses incurred after December 31, 1979. An allowance of eight cents per mile was effective for expenses incurred in calendar year 1979.. For the 1974-1978 calendar years, a seven cents per mile allowance was in effect.

You have indicated a concern that the increases in the mileage allowance permitted for the charitable contribution deduction over the past 10 years have not been adequate to compensate taxpayers for the increase in the cost of gasoline and oil. We do not believe this is the case.

The mileage allowance permitted by the Internal Revenue Service is based on cost data compiled by the General Services Administration (GSA) in connection with establishing the mileage allowance reimbursement rate for Federal employees. Prior to 1979, this reimbursement rate was based upon the cost of operating a standard size (eight cylinder) automobile manufactured in the United States. This method of reimbursement was considered appropriate since its basis, the standard size car, was representative of total automobile ownership in the United States. However, with the increased cost of gasoline and oil, an increasing number of individuals chose to operate smaller more fuel efficient automobiles. For example, in 1978, at the time that the mileage reimbursement rate was 17 cents per mile for Federal employees, based on the per mile cost of operating a standard size car, approximately 32 percent of the persons receiving reimbursement were operating compact (6 cylinder) and subcompact (4 cylinder) cars which had a cost per mile of only 13 cents and 11 cents respectively.

It was primarily in recognition of these facts that GSA, in 1979, decided to change its method for determining the mileage reimbursement rate to one based on the weighted average of the costs of operating standard, compact and subcompact cars weighted proportionately according to the nationwide registration mix of vehicles. Under the weighted average approach the appropriate rate based on 1978 figures would have been 15 cents per mile.

As indicated in our testimony, the charitable deduction mileage allowance is less than the regular mileage allowance because the charitable contribution deduction allowed under the Internal Revenue Code is limited to direct costs. Because the charitable rate is determined by and is adjusted with changes in the regular mileage allowance, we believe that the rate currently in effect is sufficient to cover the direct costs of using an automobile in the performance of services for charity except, perhaps, in the case of the least fuel efficient automobiles. Since taxpayers who operate such automobiles are free to deduct their actual costs, we do not see that anyone is disadvantaged.

We appreciate the opportunity of offering our views at the Subcommittee's recent hearing.

Sincerely,

(signed) Ronald A. Pearlman

Ronald A. Pearlman
Deputy Assistant Secretary
(Tax Policy)

The Honorable
William L. Armstrong
United States Senate
Washington, D.C. 20510

Senator **Armstrong**. My own sense of it is that there is such a vast amount of property which effectively gets locked into ownership that there would be a substantial offset. I have no basis to estimate the static loss, but I just have an instinct that there is a very large amount of property that is of all kinds, not just the kind mentioned in this bill, and that the redeployment of those assets into productive enterprises or more productive investments could have a very stimulative effect, although I acknowledge that would be difficult to measure.

Mr. **Pearlman**. If we have any data on that I will try to provide it.

Senator **Armstrong**. I would be very happy to have that.

Let me turn to the mileage issue for a moment. You testified that the Department does not favor increasing this from 9 cents to 20 cents. Could you recall for us when this was last increased?

Mr. **Pearlman**. I simply don't know when the 9 cents was increased. It has been several years, but I don't remember. But I would say—and I am not sure this is true for the 9 cents; I do know it is true for the 20 cents—that at the time the 20 cents was increased, which was a couple of years ago, it was brought up over what was believed to be the appropriate rate simply in the process of different agencies arriving at a number.

Senator **Armstrong**. You mean 20 cents was——

Mr. **Pearlman**. Twenty cents was considered excessive at the time.

Senator **Armstrong**. I see.

Mr. **Pearlman**. And that is why, in fact, no adjustment has been made since that point in time.

Senator **Armstrong**. Is 20 cents not the rate at, for example, which Federal employees are reimbursed?

Mr. **Pearlman**. I think it is. It is.

Senator **Armstrong**. I don't have any recollection of that debate particularly, but I would be amazed if we consciously put in a figure which was thought to be excessive.

Mr. **Pearlman**. If I understand the way it went correctly, there were a couple of departmental agencies involved in arriving at that rate, and that rate was an agreed rate, realizing that it exceeded the actual rate. And indeed there has been a considerable amount of pressure over the last couple of years to increase that rate, and that is really the reason it has not been increased. I don't know whether that is true with the 9 cents.

Senator **Armstrong**. I will have to do a little more homework on this, but my impression is that at the time the 9-cent rate was put into effect, gasoline was selling at 29 cents and it is now something like five times that amount or 4½ times that amount, depending on where you buy it.

Let me also be sure that we have in the record a couple of fairness questions. Just as a matter of fairness, if I am a volunteer, let's say, for the American Red Cross or for the Cancer Society, or so on, if I go out and use my own car, I can deduct 9 cents for my mileage. If I happen to be in, say, the 33-percent tax bracket on the average, I would save therefore on my taxes 3 cents per mile. If, on the other hand, I submit a bill for mileage to the Cancer Society or the Meals on Wheels, or whatever it is, they could reimburse me up to 20 cents per mile and I would have no tax liability on that. I would simply be reimbursed. Is that correct?

Mr. **Pearlman**. I don't think that is correct. I think that if you receive a reimbursement, you are required to pick up the reimbursement as income and then you would be entitled to deduct either the 9-cents mileage allowance or your actual fuel, parking fee, tolls, if you will, cost that you incurred. I don't think it would be a tax-free reimbursement.

Senator **Armstrong**. How about if I am a salesman or in some other business capacity, I submit a bill to my company for 20 cents a mile and they reimburse me. How does that work?

Mr. **Pearlman**. Well if you use 20 cents it works differently simply because 20 cents is the allowable deduction amount at the business level. If you change those facts and said 30 cents a mile, then the business travel would be put in the same position. You would have to pick up the 30 cents per mile in income and would either be eligible to deduct 20 cents a mile or your actual out-of-pocket cost.

Senator **Armstrong**. Well I just note that it seems to me that there is a substantial fairness question here that in a very significant way we are treating volunteers in a less favorable manner. And I hear your argument. You are saying that they are covering or can cover their out-of-pocket costs If they are on their way some place and they need gas, they can buy the gas and literally charge it to the charity. Or in lieu of using the 9 cents a mile, if they want to use their actual expenditures for gas and oil they can do that. But, of course, gas and oil are not the only cost of operating a vehicle. Insurance is one of them; tires are one of them. And it's very difficult for a volunteer to ever get those off. And if they got the full 20 cents deduction—again, to take a hypothetical example of someone whose tax bracket, we will say on the average is 33 percent—we are talking about perhaps a 6- or 7-cent-per-mile saving after you apply that tax rate to 20 cents a mile. Even someone who was at the highest marginal tax bracket of 50 percent would only save a dime.

And I don't think anybody would argue that you can really operate a car for a dime today.

And so even imagining someone in the highest tax bracket getting the highest amount of benefit, it is not a moneymaking scheme. It is even then less than a break even.

May I also make one other inquiry just to make a record? As I understand it, if someone is delivering meals on wheels, using their own vehicle, they can deduct 9 cents a mile which would have 3, 4, 5 cents actual effect on their—they would save that much, depending on their tax bracket. If, on the other hand, that same person flies on a commercial airline, let's say, to Honolulu for a conference of some kind that is associated with a charitable purpose, or otherwise deductible purpose, it is my understanding that they can deduct the entire cost of that trip as a charitable contribution. Is that correct?

Mr. **Pearlman**. Assuming that it is documentable. Assuming that the charitable purposes can be established, then out-of-pocket costs are deductible.

Senator **Armstrong**. In other words, the whole amount of the airline trip.

Mr. **Pearlman**. Again, assuming that it can be demonstrated that the entire trip was a charitable trip and that it was not a day in a meeting and a week of sightseeing, then yes.

Senator **Armstrong**. I understand. It has to be for a legitimate purpose.

Mr. **Pearlman**. Right. Then the entire cost may be deducted.

Senator **Armstrong**. Hotel expenses, too?

Mr. **Pealman**. Hotel expenses and any out-of-pocket costs relating to that charitable activity. That is correct.

Senator **Armstrong**. Well again, I just must note that there is a substantial fairness issue that I think that the committee will want to look at.

I would like to now turn to your testimony with respect to the El Pomar legislation. You made a point of saying that this legislation, S. 1464, is intended to exempt El Pomar Foundation from the foundation divestiture requirement. And I don't think I heard you say any more than that. I wouldn't want any misunderstanding though. The drafters of the legislation believe that it exempts El Pomar and no one else. Does the Treasury have any different thoughts than that?

Mr. **Pearlman**. We were under the impression that there might be some other foundations that might be exempted, but I think it is always the risk of having a bunch of foundations out there and not knowing the facts relating to each of them. But, no, I did not mean to imply that we were aware of other specific foundations.

[The following was received for the record:]

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

DEPUTY ASSISTANT SECRETARY

AUG 24 1983

Dear Senator Armstrong:

This letter is in response to questions you asked relating to the El Pomar Foundation during the August 1 hearing on S. 1464.

You asked whether S. 1464 would exempt any foundation other than the El Pomar Foundation from the excess business holdings rules. Neither the Treasury Department nor the Internal Revenue Service is aware of any other foundation that would qualify for the exemption provided by S. 1464. However, we do not routinely collect information that would permit us to determine whether another foundation exists that would be described by the provisions of S. 1464. Therefore, we are unable to state categorically that the El Pomar Foundation would be the only foundation exempted from the excess business holdings rules by S. 1464.

You also asked whether the Treasury Department has any reason to think that any of the abuses at which the excess business holdings legislation was directed exist with respect to the El Pomar Foundation. We have no specific information indicating that the El Pomar Foundation's ownership of the Broadmoor Hotel involves any abuses. However, a determination that none of the problems associated with excess business holdings exist in connection with the El Pomar Foundation's ownership of the Broadmoor Hotel would require a detailed investigation of the operations of the Foundation and the hotel. For example, one of the concerns addressed by the excess business holdings rules was that a private foundation might not demand the same rate of return from a business as that demanded by a taxable owner. Permitting a business to earn an unusually low rate of return or to retain an unusually high proportion of earnings may reduce or delay the benefits going to charity and provide the business with a competitive advantage over businesses owned by taxable persons. The determination of whether the El Pomar Foundation is operating the Broadmoor Hotel in a manner that provides the full benefit of the investment to charity and that is not unfair to competitors would require a review of the hotel's operations, a comparison to the operations of hotels owned by taxable persons, and consideration of the benefits that might go to charity if alternative investments were made with the Foundation's assets.

Clearly, it would be very difficult to judge whether the El Pomar Foundation's manner of operating the Broadmoor Hotel is such that none of the concerns addressed by the excess business holdings rules are relevant. In fact, the excess business holdings rules are a response to the tremendous difficulties encountered in attempting to determine on a case-by-case basis whether a particular foundation's ownership of a business results in abuses. We believe these rules are preferable to the intrusive audit activity that otherwise would be necessary to ensure that charitable assets invested in a business are dedicated solely to charitable purposes.

I appreciate the opportunity to provide you with the Treasury Department's views on S. 1464.

Sincerely,

Ronald A. Pearlman
Deputy Assistant Secretary
(Tax Policy)

The Honorable
William L. Armstrong
United States Senate
Washington, D.C. 20510

Senator **Armstrong**. Well, we will follow up on that. And I would like to ask that someone from your office take a close look at that because the intention of this bill in its present form is to deal only with El Pomar. As you know, the Senate has on two previous occasions agreed to such legislation, once in 1969 and again last year. And there are a number of other foundations who may wish to avail themselves to similar legislative treatment and, in fact, we may package something up. But the bill in its present form only applies to El Pomar. And I think that is very significant in view of your other testimony.

You mentioned in your testimony quite a number of abuses that were the cause of the legislation in the first place. On page 13 of your testimony you state the following: "These noncharitable uses included self-dealing between foundations and donors, undue delay in the delivery of benefits to charity, extensive foundation involvement in businesses resulting in noncharitable use of charitable assets, family use of foundations to control corporate and other property, and financial transactions unrelated to charitable functions."

I would just like to say to the Department that if I or the others who are interested in this legislation believe that such circumstances applied to El Pomar I would not personally sponsor such legislation. But for the record—and by the way, we have every assurance that there are none of these kinds of circumstances which clearly were prevalent among some foundations—that none of these apply in the case of El Pomar. I would like to ask if the Treasury has any reason to think that such circumstances do apply to this situation.

Mr. **Pearlman**. No, we do not, Mr. Chairman. I think the problem with any broadbased legislation such as the private foundation legislation in 1969 is that it is going to sweep into it some foundations that need to be dealt with and some that do not. If you are going to enact this kind of legislation on a fair, broadbased basis, however, that is part of the price you pay. We have no reason to believe that El Pomar is doing anything improperly. It is simply a matter of treating all private foundations on a fair basis.

Senator **Armstrong**. I understand. One last question. You state that extensive private foundation ownership of business raised a number of problems, and one of them that you point out is "a business that is owned by a tax exempt entity often has a competitive advantage over a similar business owned by taxable persons." Again, I would want to state for the record that I acknowledge that in many cases this may have been true. We do not think it is true in the case of El Pomar. I am assured that it is not by the responsible officials of El Pomar. And, in fact, they will be testifying later today and I shall again put that question to them. But for the record, does the Treasury have any reason to think that this objection applies specifically to El Pomar?

Mr. **Pearlman**. No, we do not believe so, Mr. Chairman.

Senator **Armstrong**. Well, I am very grateful to you for coming and we look forward to seeing you this afternoon.

Mr. **Pearlman**. Thank you.

Senator **Armstrong**. Thank you very much.

The committee is now very much pleased to bring forward a panel consisting of Mr. Herbert J. Lerner, chairman of the tax policy subcommittee of the American Institute of Certified Public Accounts; Mr. Greg Johnson, director of the United States Business and Industrial Council of Washington, D.C.; and Mark Bloomfield, director of the American Council of Capital Formation, Washington, D.C. All three are authorities and experts who are well known to the committee and to the Senate, old friends of mine, and I am grateful to have them here. And we are very pleased to have this opportunity to hear your testimony. I believe that it is your intention to testify on S. 1600, the Capital Gains Indexing Provision.

I would like to ask that we hear all three of the witnesses and then I will have some questions. First, Mr. Lerner, would you proceed and give us your testimony on this legislation?

STATEMENT OF HERBERT J. LERNER, CHAIRMAN, TAX POLICY SUBCOMMITTEE, AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, WASHINGTON, D.C.

Mr. Lerner. Thank you very much, Mr. Chairman. My name is Herbert J. Lerner, and I am the chairman of the Tax Policy Subcommittee of the Federal Tax Division of the American Institute of CPS's. I am pleased to appear here today to support Senator Armstrong's indexation bill, S. 1600. My comments reflect the views of the AICPA, which represents approximately 200,000 certified public accountants throughout the United States.

In their practices, CPA's apply the tax laws to a myriad of real life situations. In addition to observing the practical effects of these laws, we believe that we have a responsibility to try to help improve the tax system. In order to do so, periodicially we publish statements of tax policy which provide our perspective and analysis of major national tax policy issues. One such issue was addressed in our tax policy statement No. 9, entitled "Implementing Indexation of the Tax Laws," a copy of which is appended to my statement for inclusion in the record.

Mr. Chairman, your indexation bill is generally consistent with the recommendations of our statement, in that it provides for the indexation of the basis of assets to minimize the impact of inflation on the tax system. Your bill, coupled with the 1985 indexation of tax rates, the zero bracket, and personal exemptions, as enacted by ERTA in 1981, represents an important step toward comprehensive indexation and resulting greater equity in our system.

The 1981 act changes represented a major endorsement by the Congress of the concept of indexation of our system as it relates to the individual income tax, and I wish to reaffirm our support for those changes which become effective in 1985. But the 1981 act changes are limited to indexation of tax rates, not indexation of the tax base. It will eliminate the concerns about bracket creep for most individuals who derive their income from inflated rates of current salaries, wages, and so on. But the 1981 act will have limited effect on those who derive inflation-induced gains from the sale of an asset held for many years. The individual who derives gain from such a sale in 1985 may or may not be affected by the rate bracket adjustments, if any, for that year, and it would only be coincidental if the rate bracket adjustment bore any relationship to the distortion of real income realized on the sale of the property.

The 1985 indexation of rates only serves to preserve the rate structure established for 1984 by avoiding inflation induced changes. It does not attack the fundamental issue of how to protect individuals from taxation when there has only been nominal gain realized due to prior inflationary years. Indexation of the tax basis of property is, we believe, the solution to that problem.

Some have argued that the indexation of basis is not necessary because of the 60-percent exclusion of long-term capital gains from taxable income. We believe that the current or any such similar exclusion is neither an equitable nor an adequate method of compensating for inflation. Despite the exclusion, taxpayers who have suffered a real economic loss often are subject to tax from the sale of an asset. A simple example will illustrate this point. A 9-percent nominal gain on the sale or exchange of an asset held for more than 1 year during which time inflation was 10 percent, will result in an economic loss of 1 percent. Under our present tax structure, however, the taxpayer would be required to pay tax as if a 3.6-percent taxable gain—that is, 40 percent of the 9 percent—had actually been realized. The inequity of that result is apparent.

Indexing the tax basis of assets for gain or loss, or for cost recovery purposes, need not be unduly complex. The unadjusted basis of each asset would be multiplied by a factor which would establish the newly calculated indexed basis to be used for purposes of determining gain or loss on the disposition. The use of an indexed basis would result in the calculation of gain or loss on the sale of assets that would be consistent with the underlying economic effect.

In the interest of tax simplification, however, index factors might be determined on an annual basis rather than on a quarterly basis as proposed. Although excluded from S. 1600, we believe that indexation also should apply to tangible personal property and to the basis of assets for calculating depreciation. Depreciation charges based on unadjusted historical cost are unrealistic when they are compared with current replacement cost. Under an indexed system of depreciation, the accelerated cost recovery percentage could be applied to the indexed basis to calculate the taxpayer's depreciation deduction. Besides current tax rules pertaining to depreciation, new ones could be applied. The system of open-ended or pooled accounts, with which several of the members of this committee are familiar, is particularly well suited to indexation. Furthermore, the indexation of basis need not affect the determination of the period over which capital costs would be recovered. While use of an indexed basis for calculating depreciation would make it possible to recover more than 100 percent of the original cost through depreciation deductions, it would reflect economic reality and aid investors in dealing with the rising replacement costs of capital assets during inflationary periods.

I call this subcommittee's attention to the other indexation recommendations contained in our tax policy statement. For example, our statement also recommends that all fixed-dollar allowances or exemptions in the Code should be indexed to avoid the unlegislated erosion of the value of those provisions when they were enacted. We see indexation of the tax code—both the rate structure and the base—as essential ingredients to an improved, more equitable, tax system. There are a number of other policy and technical issues under S. 1600 that deserve further consideration by this committee and its staff, and the AICPA Federal Tax Division is prepared to work with you and the staff in the effort to address those issues, including some of the points raised by Mr. Pearlman of the Treasury Department. We welcome the opportunity to do so. Thank you.

Senator **Armstrong**. Thank you very much. I have some questions which I will come back to you after we have heard from the other witnesses.

Next, Mr. Jonsson, from the U.S. Business and Industrial Council of Washington, D.C.

[The prepared statement of Mr. Lerner follows:]

Testimony of

Herbert J. Lerner

Chairman, Tax Policy Subcommittee

Statement of American Institute of Certified Public Accountants
Before the
Taxation and Debt Management Subcommittee
August 1, 1983

My name is Herbert J. Lerner, and I am the Chairman of the Tax Policy Subcommittee of the Federal Tax Division of the American Institute of Certified Public Accountants. I am pleased to appear today to support Senator Armstrong's indexation bill, S. 1600. My comments reflect the views of the AICPA, which represents approximately 200,000 certified public accountants throughout the United States.

In their practices, CPAs apply the tax laws to a myriad of real life situations. We are in a unique position to observe the practical effects of these laws and believe that we have a responsibility to try to help improve the tax system. Periodically, we publish Statements of Tax Policy which provide our perspective and analysis of major national tax policy issues. One such issue was addressed in Tax Policy Statement Number 9, "Implementing Indexation of the Tax Laws," a copy of which is appended to my statement for inclusion in the record.

Senator Armstrong's indexation bill is generally consistent with the recommendations of our Statement, in that it provides for the indexation of the basis of assets to minimize the impact of inflation on the tax system. His bill, coupled with the 1985 indexation of tax rates, the zero bracket amount, and personal exemptions, as enacted by the Economic Recovery Tax Act of 1981, represents an important step toward comprehensive indexation and resulting greater equity.

The 1981 Act changes represented a major endorsement by the Congress of the concept of indexation of our tax system as it relates to the individual income tax. But it was limited to indexation of tax rates--not indexation of the tax base. It will eliminate the concerns about "bracket creep" for most individuals who derive their income from inflated rates of current salaries, wages, etc. But the 1981 Act will have limited effect on those who derive inflation-induced gains from the sale of an asset held for many years. The individual who derives gain from such a sale in 1985 may or may not be affected by the rate bracket, etc. adjustments (if any) for that year, and it would only be coincidental if the rate bracket adjustment bore any relationship to the distortion of real income realized on the sale of the property.

The 1985 indexation of rates only serves to preserve the rate structure established for 1984 by avoiding inflation induced changes. It does not attack the fundamental issue of how to protect individuals from taxation when there has only been nominal gain realized due to prior inflationary years. Indexation of the tax basis of property is, we believe, the solution to that problem.

Some have argued that indexation of basis is not necessary because of the 60 percent exclusion of long-term capital gains from taxable income. We believe that the current or any such similar exclusion is neither an equitable nor an adequate method of compensating for inflation. Despite the exclusion, taxpayers who have suffered a real economic loss often are subject to tax on the sale of an asset. A simple example will illustrate this point. A 9 percent nominal gain on the sale or exchange of an asset held for more than one year during which time inflation was 10 percent, will result in an economic loss of 1 percent. Under our present tax structure, however, the taxpayer would be required to pay tax as if a 3.6 percent taxable gain (40% of 9%) had actually been realized. The inequity is apparent.

Indexing the tax basis of assets for gain or loss, or for cost recovery purposes, need not be unduly complex. The unadjusted basis of each asset would be multiplied by a factor which would establish the newly calculated indexed basis to be used for determining gain or loss on disposition. In the interest of tax simplification, index factors might be determined on an annual basis, rather than quarterly. The use of an indexed basis would result in the calculation of gain or loss on the sale of assets that would be consistent with the underlying economic effect.

Although excluded from Senator Armstrong's bill, we believe that indexation also should apply to tangible personal property and to the basis of assets for calculating depreciation. Depreciation charges based on unadjusted historical costs are unrealistic wnen they are compared with current replacement costs. Under an indexed system of depreciation, the accelerated cost recovery percentage could be applied to the indexed basis to calculate the taxpayer's depreciation deduction. Besides current tax rules pertaining to depreciation, new ones could be applied. The system of open-ended or "pooled" accounts, with which several of the Senators are familiar, is particularly well-suited to indexation. Furthermore, the indexation of basis need not affect the determination of the period over which capital costs would be recovered. While use of an indexed basis for calculating depreciation would make it possible to recover more than 100 percent of the original cost through depreciation deductions, it would reflect economic reality and aid investors in dealing with the rising replacement costs of capital assets during inflationary times.

I call the Subcommittee's attention to the other indexation recommendations contained in our Tax Policy Statement and to the recommendations made in our various other tax policy statements. For example, our Statement of Tax Policy on Indexation also recommends all fixed-dollar allowances or exemptions in the Code should be indexed to avoid the unlegislated erosion of the value of a given provision due to inflation. We see indexation of the tax code--both the rate structure and the base--as essential ingredients to an improved, more equitable, tax system.

I would be pleased to respond to any questions you have.

Statement of Tax Policy **9**

Implementing Indexation of the Tax Laws

Issued by the Federal Taxation Division of the
American Institute of Certified Public Accountants

Background

Statement of Tax Policy 6, issued by the American Institute of Certified Public Accountants, states that the Institute supports the concept of indexing the Internal Revenue Code to adjust for changes in the value of the dollar. That statement presents the issues together with background information on the subject of indexation, including a summary of indexation abroad and in the United States and arguments for and against indexing.

As called for in Statement of Tax Policy 6, a new task force was established to study procedures for implementing indexation of the code. This Statement of Tax Policy results from those studies.

Recommendations

The AICPA recommends that the Internal Revenue Code be indexed to minimize the impact of inflation on the tax system. To implement this recommendation, the Institute specifically suggests that

1. Individual tax brackets and fixed dollar allowances such as deductions, credits, and exemptions be indexed.
2. Corporate tax brackets and fixed dollar allowances be indexed.
3. The basis of assets generally be indexed.
4. Assets and liabilities representing fixed dollar debt not be indexed.
5. A capital maintenance deduction not be provided for business enterprises.
6. Estate and gift tax brackets and fixed dollar allowances be indexed.
7. One readily accepted index be consistently used as the measurement of inflation.

Introduction

The U.S. economy has been subject to varying degrees of inflation during most of its history. In general, the annual rates of inflation have been relatively modest; consequently, inflation usually has not had a materially adverse effect on our tax system. However, increased worldwide inflation and recent double-digit inflation in the United States has challenged the credibility of our present tax system.

The sustained high level of inflation in recent years has convinced the public of the need to deal with inflation as more than a temporary phenomenon. Most economists, and the population as a whole, anticipate high rates of inflation into the foreseeable future. In our opinion, this mandates that Congress adjust and correct the tax system for inflation. The Institute neither supports nor opposes any particular tax rate structure or percentage exclusion for long-term capital gains. Our only objective in this statement is to preserve the congressionally determined structure from distortions due to inflation which arise after such determination. As discussed in Statement of Tax Policy 6, we have concluded that adjustment for inflation is needed and should be made by indexing the Internal Revenue Code.

Most of the basic provisions of the Internal Revenue Code were enacted at a time when inflation was not a serious problem; consequently, the major features of the code, such as income tax brackets which set marginal tax rates, and exemptions and deductions, are stated in fixed dollar terms. But inflation diminishes the real value of these items and unless they are adjusted, tax burdens will increase at a rate more than proportionate to inflation. This tax increase may be termed an *inflation tax*.[1]

The resulting increase in government revenues creates other serious economic problems which are discussed in this statement. Further, because federal income taxes generally are more progressive than state income taxes and because state income taxes generally are more progressive than related local taxes, there tends to be a greater flow of resources to higher levels of government, resulting in a distortion of fiscal balance among federal, state, and local entities. Finally, inflation creates distortion in the distribution of the total tax burden, especially against taxpayers at the lower end of the income scale.

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[1] Advisory Commission on Intergovernmental Relations, "The Inflation Tax: The Case for Indexing Federal and State Income Taxes" (Washington, D.C.: 1980), p. 1.

As the tax base (total pretax income) expands, federal revenues increase by a greater than proportionate amount. For example, the Congressional Budget Office estimates that without indexation, inflation will increase federal income tax revenues from individuals by over $22 billion in fiscal year 1981 alone.[2] A study conducted by the Joint Committee on Taxation showed that government tax revenues rise at 1.65 times the rate of increase in the cost of living. For individual taxpayers, this means that for every 10 percent rise in income, taxes increase an average of 16.5 percent. The difference represents the increase in federal revenues beyond the proportionate growth in income. The net effect is a tax increase resulting from inflation rather than from legislative action.[3]

Capital Formation

During periods of inflation, businesses have difficulty obtaining the capital necessary to modernize plant and equipment. Committing funds to the development of new inventions or business undertakings entails the acceptance of risks, but under our present system, the interaction of inflation and taxation diminishes the reward against which these risks are measured.

Many businesses seek to price their products and engage in activities so they can replace income-producing assets as they become worn or obsolete and earn a return on their original investment. If businesses underestimate the cost of replacing old assets, they will not have sufficient funds left over to finance expansion and new investments. It appears this has been happening. If one looks at the figures for the entire economy, unadjusted for inflation, business profits appear adequate to replace existing capacity while still leaving substantial amounts for new investment. However, when business costs are adjusted for inflation, real profits are seen to decrease greatly. The problem is made worse because taxes are imposed on income unadjusted for inflation, rather than on real economic profit. Thus, after adjustment for inflation, the pool of net savings available for new capital investment has been decreasing steadily.

The AICPA has addressed one aspect of capital formation in Statement of Tax Policy 7, *Analysis of Capital Cost Recovery Pro-*

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[2] Congress of the United States, Congressional Budget Office, "Indexing the Individual Income Tax for Inflation" (Washington, D.C.: 1980), p. X.

[3] U.S., Congress, Senate, Committee on Finance, Hearing before the Subcommittee on Taxation and Debt Management Generally, 95th Congr., 2d sess., 24 April 1978, statement of Senator Robert P. Griffin.

posals (STP 7). As that statement noted, the simplest and most effective hedge against the erosion of investment caused by inflation is the immediate write-off of capital expenditure, so the tax benefits from invested funds are immediately available for further investment. The statement further concluded that, next to immediate write-off, indexing cost recovery allowances would provide the best hedge against inflation because it addresses the problem most directly and completely.

Statement of Tax Policy 7 made its final recommendations on the basis of three criteria. Inflation was one. The other criteria were the current need for investment incentives, and simplification. When all three criteria were considered, it was concluded that "the optimum solution would be to adopt the mechanics of the SCR [simplified cost recovery] system [the pooled asset accounting concept as embodied in H.R. 7015] but to modify the recovery approach so that, at least for tangible personal property, the tax benefits from depreciation would approach those under CCRA [Capital Cost Recovery Act—H.R. 4646 and S. 1435, also known as "10-5-3"]." These bills were introduced in the 96th Congress; the approaches they embody will be extensively debated in the 97th Congress.

The primary reason that indexation of depreciation was not chosen as the final recommendation of Statement of Tax Policy 7 was that it would create additional complexity in the tax code. This point was considered significant because it was thought that if indexation were adopted, "the present depreciation systems, such as ADR, would likely be continued with many of their inherent complications." Statement of Tax Policy 7 also concluded that the "complexity of indexation is usually overstated—sometimes greatly." The statement went on to note that "indexation techniques could be combined with other cost recovery proposals, including CCRA or SCR," and that indexation would become relatively more attractive if inflation became worse. Although no such proposal had been suggested at the time Statement of Tax Policy 7 was written, it is now recognized that a system of pooled accounts could be indexed and still provide considerable simplification.

Political Accountability

The inflation tax creates a tax increase in the absence of legislative action or public debate. Thus, the electorate cannot place responsibility for this increase in government revenues on any specific group of elected officials. Often Congress has passed what were purported to be tax cuts, but these did nothing more than reduce the inflation tax. In the past decade, there have been several legislated tax cuts, yet the actual tax bill of most citizens, as a percentage of personal income, has increased rather than decreased.[4]

Unless tax increases are enacted, indexing the tax code would slow down the growth in government revenues, preventing them from increasing faster than inflation. Real increases in revenue would have to result from real economic growth, which would help maintain the division of resources between the public and private sectors. Also, real tax cuts would be clearly identified as such.[5] An indexed tax code would enable voters to identify responsibility for their taxes and to hold elected officials accountable for tax increases.

Conformity

Inflation can have a significant impact on the determination of income for both tax return reporting and financial accounting purposes. Until the past decade, when the rate of inflation rose rapidly, there had been little motivation or sense of urgency for either Congress, in the case of our tax laws, or the accounting profession, in the case of financial accounting, to develop techniques for determining the consequences of such impact. The accounting profession and the Financial Accounting Standards Board presently are examining the feasibility of adopting inflation-adjusted financial statements. Although no one definitive method has been adopted at this time, several have been suggested and two are currently being tested.

The courts have recognized that the purposes of financial statement reporting and income tax reporting are not the same.[6] While the primary goal of financial accounting is to provide useful information to management, shareholders, creditors, and other interested parties, the primary goal of the income tax system is the equitable collection of tax revenue. In addition, the income tax system is used to accomplish various social purposes mandated by Congress. Regardless of whether, or how, inflation adjustments are made for financial reporting purposes, indexation is necessary to maintain the credibility and equity of the tax system.

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4. *Ibid*.
5. "The Inflation Tax," p. 18.
6. *Thor Power Tool Co*., 439 U.S. 522 (179), aff'g 563 F. 2d 861 (7th CIR. 1977) aff'g 64TC154 (1974).

Income Taxes

Individual Tax Brackets and Fixed Dollar Allowances

As inflation causes prices and incomes to rise, our progressive tax structure places taxpayers in higher marginal tax brackets, which results in their paying a greater portion of their income in tax to the federal government each year. This increase in tax beyond the rate of inflation is known as the *inflation tax*.

To illustrate this tax, consider the example of a family of four whose money income has increased from $15,000 to $16,500 to keep pace with one year of 10 percent inflation. Although the family's pretax purchasing power is the same—that is, its real income before taxes in economic terms has not changed—the family has jumped from an 18 percent marginal tax bracket to a 20 percent marginal tax bracket. In total, the family's federal income tax burden has increased from $1,242 to $1,530. The net result is an increase in tax liability of 23 percent, based on a money increase of only 10 percent and a decrease in after-tax real income.[7]

If the tax liability had risen at the same rate as inflation, 10 percent in our example, then the total tax liability would have increased only $124 (from $1,242 to $1,366) and neither the family nor the federal government would have had economic gain or loss because of inflation. Instead, the tax liability increased $288 (from $1,242 to $1,530). Although the family's income before taxes rose sufficiently to keep pace with inflation, the family now pays a larger portion of its income in taxes and its after-tax purchasing power is reduced by $164, the amount of the inflation tax.

If the family's money income had remained constant, the purchasing power of that income would have been reduced by inflation. Indexation would at least reduce the tax cost, thereby mitigating the loss of real income.

In conclusion, under an indexed tax code, the validity of a progressive tax structure would be maintained. There would continue to be greater tax liability at higher levels of income, but the increase in tax liability would result from increases in real income or purchasing power, not just from inflation, and the added tax associated with inflation-related increases in income would be eliminated.

Tax Equity

Inflation distorts the legislated distribution of the tax burden. Under the present system, inflation significantly increases tax liabilities at all income levels, but the greatest burden is borne by lower-income groups. Indexing the tax code would maintain an equitable distribution of the tax burden by tying the tax base to real income, thus avoiding the shift in the tax burden caused by inflation. This would give greater credibility to the notion that our system of taxation really embraces an "ability-to-pay" concept.

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[7] "The Inflation Tax," p. 2.

For example, the tax increase generated by one year of 7 percent inflation is as high as 15.5 percent at the $15,000-level and as low as 11.1 percent at the $25,000-level. At this rate, the tax liability on $15,000 of real income will more than double by 1984. The disproportionate impact of the inflation tax on low-income families is presented graphically in Figure 1.[8] The tax increase caused by inflation is highest at the $10,000- and $15,000-income levels and declines gradually as income increases until the $35,000-income level, at which point it accelerates again.

There are really two components of the inflation tax that explain the disparity in the effect of inflation on various groups. First, inflation erodes fixed dollar amounts. Low-income groups are most affected by the loss in value of personal exemptions since their personal exemptions are larger in proportion to income. Also, low-income taxpayers generally do not itemize deductions. They usually use the zero bracket amount (formerly the standard deduction), another fixed dollar amount that is being eroded by inflation. Itemized deductions are more likely to be used by taxpayers at higher income levels.[9] Since itemized deductions are based on actual expenditures, they tend to increase with inflation. (To the extent this is so, itemized deductions are self-indexing.) Second, as income increases, taxpayers are placed in higher marginal tax rate brackets, a phenomenon known as "bracket creep." This is especially true if the relative width of the tax brackets narrows, as happens for taxable income between $20,000 and $45,000.

Indexing Tax Brackets

Indexing the income tax brackets need not make the tax code more complicated, nor would it make the completion of tax forms more difficult. An inflation factor, generally based on the U.S. Consumer Price Index (CPI, see the section entitled "Measurement" in this statement), would be computed for the change in the CPI for a twelve-month period ending prior to the commencement of the tax

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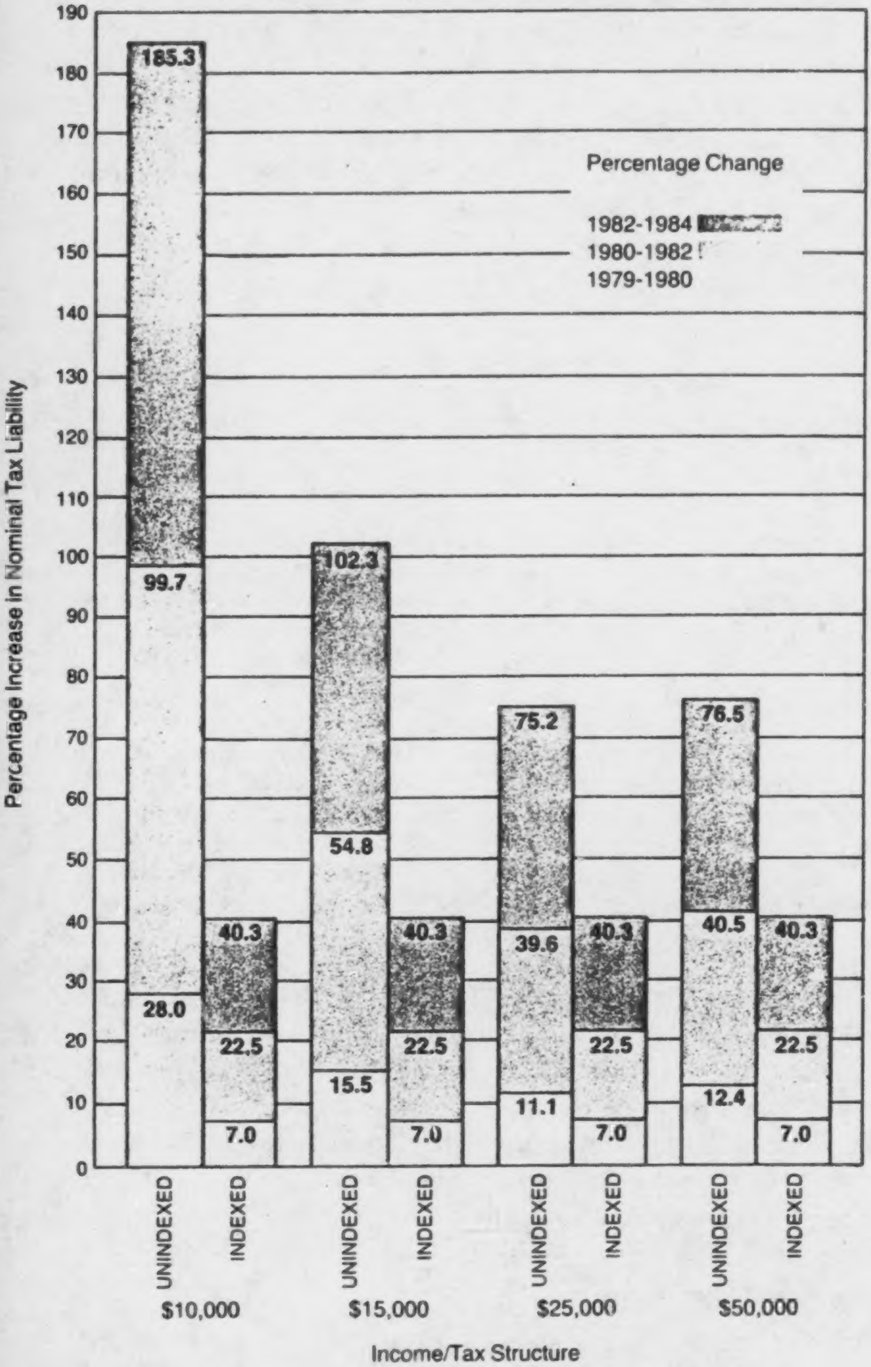
8. *Ibid*., p. 5.
9. *Ibid*., p. 4.

Figure 1

How the Inflation Tax Affects Different Taxpayers



Source: The Inflation Tax: The Case for Indexing Federal and State Income Taxes.

year. Thus, the tax brackets in any particular year would be adjusted by the rate of inflation for the prior year. As of each January 1, the brackets should be known for such purposes as withholding and estimated tax payments. To allow sufficient time to calculate the inflation factor and publish new rate tables, the CPI for the twelve-month period ending with the third quarter of each calendar year should be used to adjust the rates of the succeeding year. This use of the third quarter CPI from the prior year would result in an inflation factor that is "lagged" by fifteen months.

Using the figures provided below as an example, the inflation factor would be determined in the following manner:

	CPI*
3rd Quarter, 1979	200
3rd Quarter, 1980	220
3rd Quarter, 1981	250

*CPI Base Year 1967 = 100

> Assuming that indexation began in 1980 and using 1980 as the base year, the marginal tax brackets for 1981 would be determined by adjusting the 1980 marginal tax brackets by the percentage increase in the CPI from 1979 (200) to 1980 (220), which is 10 percent (20/200). Marginal tax brackets for 1982 would involve adjusting the 1980 marginal tax brackets by 25 percent (50/200).
>
> The inflation factor would then be applied to the upper and lower boundaries of each marginal income tax bracket. For example, assume that during the base year taxable income between $6,200 and $7,200 is taxed at $450 plus 17 percent of the excess over $6,200. After the CPI has increased 10 percent, the marginal tax brackets would be adjusted so that income between $6,820 (110 × $6,200) and $7,920 (110 × $7,200) would be taxed at $495 (110 × 450) plus 17 percent of the excess over $6,820.

To avoid working with unwieldy amounts the revised figures should be rounded to the nearest hundred dollars. Since annual adjustments are made in terms of the base year and not the previous year, rounding errors would not be compounded.

If Congress decides to change the structure of the tax brackets, it could issue a new set of tax tables. These could then be indexed, with the year of enactment as the new base year.

Indexing Fixed Dollar Amounts

Indexing the fixed dollar amounts in the tax code is not conceptually or mechanically different from indexing tax brackets. The difference lies in the variety of fixed dollar amounts contained in the code and the wide range of purposes they serve. Regardless of whether a single inflation factor or special purpose indexes are used, fixed dollar amounts must be indexed to alleviate the effects of inflation. The following is a representative listing of fixed dollar amounts contained in the tax code, with an explanation of the effects of inflation (measured by changes in the Consumer Price Index) from the dates these provisions were enacted through March 1979.[10]

Dividend Exclusion. Section 116, as amended in 1964, allows an individual to exclude $100 of dividends from gross income. Inflation effectively eroded 56 percent of the benefits of the provision. Accordingly, the exclusion is equivalent to $44 rather than $100.

Death Benefits. Section 101, introduced in 1954, excludes $5,000 of employee death benefits from gross income. This amount has never been revised, and inflation has effectively reduced the benefit of the exclusion by 62 percent (an effective exclusion of $1,900).

Fellowship Exclusion. Section 117, introduced in 1954, excludes from gross income $300 "per month" of fellowship grants received by a nondegree candidate. This exclusion has never been increased and the benefit has effectively been eroded by 62 percent (an effective exclusion of $114).

Group Term Life Insurance. Section 79, introduced in 1964, provides that an employee need not include in gross income the cost of $50,000 of group term life insurance provided by his employer. The amount has never been adjusted and is effectively reduced 56 percent by inflation to $22,000.

Casualty Loss. Section 165(c)(3), introduced in 1964, limits casualty losses of individuals to amounts in excess of $100. This amount has never been adjusted, resulting in a 56 percent effective reduction. Here inflation benefits the taxpayer using the provision.

Medical Insurance. Section 213(a)(2) has allowed a deduction of $150 for health insurance premiums since 1967. This amount has not been revised and has effectively been reduced 52 percent by inflation.

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[10] Kevin J. O'Brien and Jerry A. Menikoff, "Aspects of Indexing Taxes for Inflation" in *Tax Notes*, 21 January 1980, p. 59. Taxation With Representation Special Report, January 1980.

Moving Expenses. Beginning in 1970, Section 217(b)(3)(A) allowed a $1,000 deduction for certain moving expenses. This limitation was raised to $1,500 in 1977. In spite of that increase, inflation eroded 17 percent of the 1977 deduction.

Child Care Credit. For 1976 and thereafter, Section 44A allows a credit of up to $2,000 for child care expenses. Inflation has eroded the maximum benefit of this credit.

The inflation factor should be applied each year to the foregoing amounts, to the marginal tax brackets, and to such items as

- Personal exemptions.
- Zero bracket amounts.
- Limits on the amount of earned income eligible for the earned income credit.
- Limits on the amount of income eligible for the tax credits for the elderly.
- The $25,000 limit on the amount of tax that can be offset by the investment tax credit without regard to the present 70 percent limitation.
- The $10,000 exemption from the minimum tax.
- The $100,000 limit on the tax exempt gain from the sale of a home by a person age 55 or over.
- The $1,500 and $1,750 limits on annual contributions to an individual retirement account.
- The $7,500 limit on annual contributions to a self-employed individual's pension.
- The $3,000 limitation for capital losses which can offset ordinary income.

An inflation adjustment for items carried over and carried back could be provided. However, as discussed below, we believe that implementation of such an adjustment would create a substantial degree of complexity. Consequently, we do not recommend it at this time.

Income Tax Brackets and Fixed Dollar Allowances for Trusts and Estates

Trusts and estates are subject to income tax just as individuals are. We recommend that income tax brackets and fixed dollar amounts for trusts and estates be indexed in the same way as for individuals.

Corporate Tax Brackets and Fixed Dollar Allowances

Corporate income is taxed at graduated rates, with a top marginal rate of 46 percent applied to taxable income over $100,000. Similarly, there are a variety of fixed dollar exemptions, limitations, tax credits, and so on that are applicable to corporations. For example, the accumulated earnings tax is levied at 27 percent on the first $100,000 of accumulated taxable income in excess of the accumulated earnings credit (which is presently $150,000) and at 38.5 percent on amounts in excess of $100,000. We recommend that corporate tax brackets and fixed dollar amounts be indexed in the same manner as for individuals.

Allowances for items carried over and carried back theoretically should be adjusted for inflation since they do not represent price levels current at the time taxes are paid. For example, net operating losses, investment tax credits, and foreign tax credits, which may be carried back or forward, could be adjusted to reflect the impact of inflation on their values. Although adjusting items carried over and carried back would be theoretically correct, such adjustments would create significant complexities. Therefore, we do not recommend such adjustments at this time.

Basis of Assets Generally

We consider inflation to be a sufficiently serious problem that in addition to indexing tax brackets and fixed dollar amounts, the tax basis of assets (with certain exceptions) should be indexed too. It should be noted that this concept was included in S. 2738, introduced in the U.S. Senate in 1978.[11]

It has been argued that indexation of basis is not necessary because of the 60 percent exclusion of long-term capital gains from taxable income. While we do not take a position at this time as to what exclusion should be allowed for capital gains, we believe that any such exclusion is neither an equitable nor an adequate manner of compensating for inflation. Despite the exclusion, taxpayers who have suffered a real economic loss often are subject to tax on the sale of an asset. A simple example will illustrate the point. A 9 percent taxable gain on the sale or exchange of an asset in a year when inflation is 10 percent will result in an economic loss of 1 percent. Under our present tax structure, however, the taxpayer would be required to pay tax as if a 9 percent profit had actually been realized.

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[11] S. 2738, 95th Congr., 2d sess., 1978 (bill not enacted).

We are convinced that the complexity of indexing basis is usually overstated. It would not be difficult to have the adjusted basis of assets multiplied by an inflation factor. The newly calculated indexed basis would be used for determining gain or loss on disposition, as well as for calculating depreciation. The use of an indexed basis would result in the calculation of gain or loss on the sale of assets that would be consistent with the underlying economic effect.

In periods of rising inflation, businesses are unable to recover through depreciation sufficient funds to replace the assets being depreciated. Depreciation charges based on unadjusted historical costs are unrealistic when they are compared with current replacement costs. Further, when these assets are sold, inflation causes economic gains to be overstated. Inadequate depreciation allowances, combined with the taxation of inflated gains and the higher replacement costs of capital goods, limit the ability of businesses to internally generate the funds needed for capital outlays. As indicated in the introduction, the AICPA has published a separate booklet, Statement of Tax Policy 7, *Analysis of Capital Cost Recovery Proposals*, dealing with depreciation. We refer the reader to that study for our recommendations on how methods of cost recovery should be modified.

Under an indexed system of depreciation, the applicable depreciation method (either the straight-line or an accelerated method) would be applied to the indexed adjusted basis to calculate the taxpayer's depreciation deduction. Either current tax rules pertaining to depreciation or new ones could be applied. The system of open-ended or "pooled" accounts recommended by Statement of Tax Policy 7 is particularly suited to indexation because even with indexation this method of depreciation would be much simpler than the methods presently allowable for computing depreciation deductions. The indexation of basis would not affect the determination of the period over which capital costs would be recovered. Thus, the taxpayer could use an estimated useful life, the asset depreciation range system, or any recovery period set forth under a capital cost recovery program. Use of an indexed basis for calculating depreciation would make it possible to recover more than 100 percent of original cost through depreciation deductions.

For reasons described in the next section of this statement, we recommend that the basis of assets and liabilities representing fixed dollar debt (bonds, notes, payables, receivables, and so on) not be indexed. We recognize that there may be situations in which an asset that does not have a fixed dollar value is so supported by fixed dollar assets as to be virtually indistinguishable from them, such as a share in a mutual fund that holds only bonds. We are confident that legislation or regulations can be drafted to deal with such situations for which indexation of basis would not be appropriate.

Because of the complexity involved, we do not, at this time, recommend indexation for determining the gross profit from sales of inventory. Generally, the LIFO method of inventory valuation is available to associate current costs with current selling prices. On those occasions when LIFO fails to match costs (for example, when LIFO layers are invaded) there would be recognition of inflation-induced gains. To mitigate this problem, the AICPA is currently considering recommending a tax law change that would allow the reestablishment of eroded LIFO layers within certain limited periods of time.

Assets and Liabilities Representing Fixed Dollar Debt

The rate of interest negotiated between a lender and borrower represents the pure cost of money (the risk free interest rate) plus a premium for risk. The risk premium includes the anticipated rate of inflation. In recent years, inflation has become an increasingly important element in the interest rate structure. If, for example, the pure cost of money is 3 percent, lenders will be reluctant to lend money at 3 percent when the rate of inflation is 5 percent.

The rate at which the lender will loan money will also depend on the lender's tax rate because the lender is seeking to maintain his after-tax rate of return. If the lender's marginal tax rate is 50 percent, under stable prices, his after-tax rate of return is 1.5 percent. If inflation is 5 percent, the lender will seek to raise the before-tax rate of interest to 13 percent. This is determined by viewing the 13 percent as 6.5 percent after tax and then subtracting 5 percent for inflation, which in real terms is equivalent to earning 1.5 percent before inflation.

Thus, from the lender's point of view, the fluctuation of interest rates makes a separate adjustment for inflation unnecessary. If the borrower is in the same tax bracket as the lender (50 percent), he will need no adjustment either. Under stable prices, the borrower had to pay 3 percent, but this was a deductible expense so that after tax the borrower's real cost was 1.5 percent. Now the borrower has to pay 13 percent interest, but this, too, is deductible, so that his after-tax interest expense is 6.5 percent. Since the borrower is repaying the loan with depreciated dollars, after subtracting the 5 percent rate of inflation the real cost of borrowing is 1.5 percent.[12]

To the extent that market rates of interest adjust for anticipated inflation, a tax adjustment for debt instruments is unnecessary. However, there are qualifications to this position. For example, there will be discrepancies and lags among nominal rates of interest, real rates of interest, and the rate of inflation. In recent times, the rate of inflation has not always been fully anticipated, as shown by declining market values of long-term bonds, savings and loan mortgage portfolios, and the long-term debt instruments held by various financial institutions issued at lower interest rates. In periods of inflation, the borrower repays long-term debt with "cheaper dollars," which in the view of some gives rise to an economic gain. However, this gain may be considered as offset by a loss to the lender. Therefore, looking at the economy as a whole, the determination of income is approximately correct.[13]

If creditors and debtors are not in the same tax bracket, any rise in interest rates can have redistributive effects. A recent study considers the inflation-induced distortions that emerge as corporate income passes through the corporate and individual tax systems.[14] This analysis concludes that the tax benefit resulting from the ability of corporations to deduct interest was slightly more than offset by the tax penalty suffered by the holders of the debt, since the effective tax rate for individual recipients of interest was slightly higher than the effective corporate rate.

Finally, institutional barriers prevent certain creditors from adjusting their rates of return for inflation. For example, laws set limits on interest rates that may be paid on savings accounts. These institutional barriers have resulted in disintermediation, whereby investment dollars have flowed to those instruments and institutions offering the highest rates of interest for a given level of associated risk.

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[12] Hearings on S. 2738, 95th Congr., 2d sess., 1978, statement by Emil M. Sunley, Deputy Assistant Secretary for Tax Analysis.

[13] *Ibid.*

[14] Feldstein, Martin and Summers, Lawrence, "Inflation and the Taxation of Capital Income in the Corporate Sector," Working Paper No. 312 (Cambridge, Mass.: National Bureau of Economic Research, 1979.)

The result is that the aggregate effect of those institutional barriers is offset as investors seek the highest returns available. In this connection, it may also be noted that Congress is addressing this issue of removing restrictions on interest rates on savings.

Although market adjustments will always be less than perfect, the theoretical and empirical evidence indicates that inflation is anticipated by lenders and borrowers so that gains and losses are, on the whole, substantially offset and the overall determination of net income is not affected. To create perfect adjustments would require a tax code that would be enormously complicated and impractical. The interactions of the free market result in rates of interest that sufficiently adjust to and anticipate the rate of inflation so that it is unnecessary to index the basis of fixed dollar assets and liabilities.

The Capital Maintenance Deduction for Net Worth

Some countries (most notably Brazil) that have experienced rates of inflation significantly higher than the United States have provided businesses with a capital maintenance allowance designed to compensate business enterprises for the eroded buying power of their equity.

Briefly stated, a capital maintenance allowance is a deduction or adjustment that applies the inflation rate to net worth as adjusted for nondepreciable and nonfinancial assets. Thus, the capital maintenance allowance would be calculated by comparing the beginning and ending net worth of a company after eliminating static assets, such as LIFO inventory, land, goodwill, or other fixed assets which are not adjusted for depreciation. The capital maintenance allowance could be determined at various points during the year or with beginning and ending averages. In a complex and changing economy, we believe that the difficulties in record keeping, administration, and calculation under a capital maintenance provision would outweigh the benefits that might result and therefore conclude that a capital maintenance allowance is not needed at this time.

Estate and Gift Taxes

In 1942, Congress determined that decedents with taxable estates valued at more than $60,000 should pay an estate tax and that persons who made gifts of over $30,000 during their lifetimes (excluding annual gifts of $3,000 or less to each individual donee) should pay a gift tax. At that time, these figures constituted Congress' view of a fair distinction between those who should and those who should not pay a tax on the transfer of their wealth.

From 1942 to 1976, as inflation eroded the value of the dollar, more and more of the population passed over those threshhold amounts. Some became relatively more wealthy, but others, such as wage earners and many farmers and small businessmen, crossed the threshhold only because it is defined in terms of the ever eroding dollar. Their income and assets stated in dollars had grown but their purchasing power had not grown proportionately. As a result, every year a greater number of individuals became subject to these transfer taxes.

When Congress acted in 1976 to reform the estate and gift tax provisions of the Internal Revenue Code, it did little to counteract inflation as a taxing agent. It left the annual gift tax exclusion at $3,000. It did abandon the $60,000 exemption from estate taxation, replacing it with a $47,000 credit against the tax (beginning in 1981). The credit is popularly referred to as the equivalent of an exemption of $176,000, but this is accurate only with respect to the lower end of the estate tax scale. For estates falling into the highest bracket, the $47,000 credit is the equivalent of only about a $67,000 exemption. Prior to the 1976 reforms, the $60,000 exemption reduced taxes by $46,200. Thus, the change did not adequately adjust for inflation. The reduction of the top estate tax bracket from 77 percent to 70 percent was not an adequate response to inflation either; rather, it was a trade-off for enactment of the unified transfer tax, the subsequently revoked carry-over of basis rule, and the generation-skipping transfer tax. The unified transfer tax not only raised the gift tax rates as high as those of the estate tax (prior to the 1976 reforms they had been three-quarters of the estate tax) but also provided that taxable gifts be drawn back into the tax base at the time of the donor's death. In addition, the scale of rates was shifted higher, and the top brackets are now reached more rapidly.

The reform legislation relaxed the tax burdens only in a few, selected areas. The smallest estates gained some relief from the new unified credit, the minimum marital deduction, and special valuation methods for real property used as a farm or in a trade or business. However, the limited relief available to these specific hardship cases is fast dwindling. In each case the relief was provided in fixed dollar terms: the $47,000 credit, the $250,000 minimum marital deduction, and the $500,000 maximum decrease of valuation for qualified farm and small business real property. Consequently, as time passes, inflation shrinks the effectiveness of the relief. At an annual inflation rate of 10 percent, $350,000 in 1988 and $700,000 in 1995 will be needed to furnish the same purchasing power that $176,000 provides in 1981.

Congress ought to establish the level of real wealth that should be subject to the estate, gift, and generation-skipping transfer taxes, and this level should then be maintained by indexation. Inflation should not push individuals not previously subject to transfer taxes above the minimum level of taxation and then ever highter up the scale of transfer tax rates. In an indexed system, only a true increase in wealth would have this effect.

The estate, gift, and generation-skipping transfer tax provisions are readily subject to indexing in the same manner as income tax brackets and fixed dollar amounts. The upper and lower boundaries of each tax bracket and the credit for state death taxes can be modified annually by reference to cumulative changes in the CPI. In similar fashion, the applicable fixed dollar amounts may be adjusted for inflation. The inflation factor determined annually should be applied to amounts such as the following:

1. The unified credit against estate and gift taxes, and, to the extent available, against the generation-skipping transfer tax.
2. The $500,000 limit on decrease of valuation for qualifying farm or other trade or business real property.
3. The $500,000 limit on decrease in the value of the gross estate in recognition of material participation in a farm or other trade or business by the surviving spouse.
4. The $250,000 minimum marital deduction.
5. The orphan's exclusion, presently $5,000 for each year that a child is younger than twenty-one.
6. The annual exclusion of gifts up to $3,000 to each donee.
7. The limit of $5,000 upon the exclusion from gift taxation of a general power to appoint property.
8. The limit of $100,000 on excludable gifts to a spouse.
9. The $250,000 limit on excludable generation-skipping transfers.

In the case of estate and gift tax provisions, the due dates of the returns permit reference to CPI figures at the close of the calendar year rather than to those of the third quarter, as would be necessary for income tax purposes. Furthermore, we recommend no more than annual adjustment. Although the taxes apply to transfers at particular moments in time, the reference to a figure which applies to an entire calendar year would be a simple process and would be sufficient to relieve the problem to which indexation is addressed.

No adjustments are recommended to the amounts of prior gifts or taxes paid thereon. Since these amounts generally are reciprocal their indexation would serve little practical purpose. Thus, only the unused portion of the unified credit would be indexed. This refers to amounts such as the following, which would not be indexed:

- The amount of adjusted taxable gifts taken into account in computing the tentative estate tax and the amount of the credit against the estate tax for gift taxes paid by the decedent.
- The aggregate sum of the taxable gifts and the gift taxes of preceding years taken into account in computing the gift taxes of a particular year.
- The amount of the credit against the estate tax for taxes paid on a prior transfer to the decedent.

Measurement of Inflation

The AICPA believes that the index used to measure inflation should be readily accepted by broad segments of society and should be capable of being consistently applied. Further, we support the use of a single general purpose index. Although arguments have been made that an indexation system should use different indexes for different items so that alternative indexes could be used for specific applications, we believe this would add complexity to the tax code.

An index such as the Consumer Price Index (CPI) would generally meet these requirements. The CPI is a widely used measure of inflationary pressures and of changes in the purchasing power of the consumer dollar. It is the most familiar index, and it is currently used in the Internal Revenue Code and by various states that have adopted indexed tax systems. In addition, among the countries that use indexation in their tax structures, nearly all make use of their equivalent of the CPI. While imperfect, the CPI generally reflects price changes for things people must buy in order to live—food, clothing, rent, household supplies, medical expenses, public utility rates, and so on.[15]

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[15] U.S., Department of Labor, *BLS Handbook of Methods for Surveys and Studies* (Washington, D.C.: Government Printing Office, 1976), p. 88.

All statistical surveys, by nature, lend themselves to possible inaccuracies, and the CPI as a general measurement of inflation has been criticized for a number of reasons. Shortcomings of the CPI may arise from inaccurate reporting, lack of systematic incorporation of new outlets into the sample, and introduction of new products or changes in product quality.[16] It should also be noted that the CPI has not been developed for use in measuring nonconsumer price level changes.

However, the public generally considers the CPI the official government indicator of inflation. It has widespread use in wage and collective bargaining negotiations. An index based on the CPI is used for Social Security payments and for fixed dollar limitations for defined benefit plans and defined contribution plans.

In conclusion, we believe that a single generally accepted and consistently applied index should be used. Whatever index is selected, it is important that it be continually monitored and adjusted to reflect changes in the economy.

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[16] Edward Meadows, "Our Flawed Inflation Indexes," *Fortune*, 24 April 1978, p. 67.

STATEMENT OF GREG JONSSON, VICE PRESIDENT AND COUNSEL UNITED STATES BUSINESS AND INDUSTRIAL COUNCIL, WASHINGTON, D.C.

Mr. JONSSON. Thank you, Mr. Chairman. I appear before you today as the counsel for the U.S. Business & Industrial Council in support of S. 1600. Let me first say that I concur with the testimony given by the previous witness, especially with respect to his statement on depreciation and the need to index that portion of the Tax Code.

USBIC is a national organization of 3,000 senior corporate executives from predominantly medium-sized companies representing all sectors of the U.S. industry. It is a group particularly dedicated to defense of the traditional free enterprise system, composed of many entrepreneurs and independent owners of closely held firms. The objective of private enterprise is not to maximize return to the U.S. Treasury but rather to minimize the tax exposure to enterprise. With respect to statements made by one of the previous witnesses, there will undoubtedly be a revenue impact associated with capital gains indexing, but it should not be viewed with alarm. A recent analysis of the Council of Economic Advisors has indicated that the amount of capital gains reported on tax returns increased dramatically in the year after the tax rate on capital gains was reduced, that is, more revenue at a lower tax rate. The anticipated revenue loss prior to the reduction was certainly exaggerated and I think that the revenue loss associated with indexation of capital gains tax is also likely to be exaggerated.

Just as USBIC views the Economic Recovery Tax Act of 1981, ERTA, as a profound turning point in the history of U.S. tax policy, we also view the import of S. 1600 as a logical extension of that policy. ERTA is nothing less than a first attempt to slow the increase in the Federal Government's share of our gross national product. S. 1600 is an interim step in the same direction for capital assets.

Prior to the passage of ERTA, it was estimated that the Federal Government would claim more than 21 percent of GNP in the years 1981 to 1985, and a continuously rising share thereafter. By reducing marginal tax rates for individuals by 25 percent over 3 years the Government's claim of GNP was reduced to an estimated 17.4 percent, and after adjustments via the highway gasoline tax and the Tax Equity and Fiscal Responsibility Act of 1982 [TEFRA] to about 18.6 percent of GNP.

One of the most significant features of ERTA is the provisions for the annual indexing of individual income tax brackets, the zero bracket, and the personal exemption in accordance with rises in the Consumer Price Index for Urban Households, to begin in calendar year 1985.

Indexing the tax basis of capital assets would eliminate the unfair and prejudicial effects of current law. Indexing parity between income and capital gains tax will force the Congress to confront head-on the underlying economic conditions which necessitate its use. Once indexing is in place, Congress will either have to approve continuous and regular tax increases for expenditures, something inflationary bracket creep has allowed them to avoid, or fight the inflation that the Nation will once again inevitably face in response to horrendous budget deficits projected for the rest of this decade.

As USBIC has stated many times in its policy statement, inflation can be purged from our economy only by substantial reductions in Federal spending, particularly spending on entitlements. There can be no doubt that the widespread support for indexing as a concept is an expression of the American peoples' deep dissatisfaction with congressional failure to reduce deficits without visiting inflation on the economy.

In view of the widespread support for indexing, and given its obvious benefits, it is difficult to understand how it can be opposed on economic grounds. ERTA was approved by the U.S. House of Representatives by a decisive vote of 238 to 195. Yet today, just 2 years later and 17 months before indexing is to take effect, it is facing strenuous opposition. USBIC believes that the basis for these efforts to repeal indexing and resistance to the idea of extending indexing to capital gains is an unwillingness by Congress to accept fiscal discipline. Indexing is a means to insure that real tax revenues are consistent with real economic growth. To the extent that nominal capital gains represent simple inflation in asset values, no additional real capital is created, and taxation of those gains erodes our capital base. We must index the basis of productive assets so that the inflation component will not be subject to tax.

If revenues to the U.S. Treasury are restricted to the actual growth in the Nation's economy rather than the fictional growth attributable to inflation, the beneficiaries of inflation—Congress and certain special interests tied to entitlements—would become accountable to the taxpayer once again. USBIC believes that real economic growth is the best hope for ameliorating the deep and traumatic economic problems caused by the recession of 1981 and 1982. We believe that real growth can only be sustained if consumers, producers, and investors are confident that the labor they perform and the risks they take—in short, enterprise—will not be penalized by the hidden tax of inflation.

Tax reduction, the centerpiece of ERTA, is the only effective means available to the American people by which to impress upon the Congress the need to reduce Federal spending. Without ERTA's indexing feature and without the extension of this approach to capital gains, Federal revenues will continue to increase from bracket creep, notwithstanding the recent tax reduction features enacted by Congress. This is the legacy of inflation as well as the greatest economic threat for America's future.

USBIC specifically endorses the indexation of the capital gains tax to the GNP deflator, which is the substance of S. 1600. Thank you.

Senator ARMSTRONG. Mr. Jonsson, thank you very much for a fine statement. And I especially thank you for pointing out that real economic growth is the best hope for solving the economic problems that our country faces. I will be back to you in a moment.

Next, Mr. Mark A. Bloomfield, executive director of the American Council of Capital Formation. Mr. Bloomfield.

[The prepared statement of Mr. Jonsson follows:]

Prepared Testimony of the U.S. Business & Industrial Council
For the Senate Committee on Finance (August 1, 1983)

Mr. Chairman, distinguished Senators:

My name is Gregory N. Jonsson and I appear before you today as Vice President & Washington Counsel of the U.S. Business & Industrial Council.

USBIC is a national organization of 3,000 senior corporate executives from predominantly medium-sized companies representing all sectors of U.S. industry. It is a group particularly dedicated to defense of the traditional free enterprise system.

This year the Council observes the fiftieth anniversary of its founding. Our position supporting legislation to index capital gains to a reliable measure of inflation is an expression of our free market philosophy.

We believe that the Economic Recovery Tax Act of 1981 (ERTA) represents a profound turning point in the history of U.S. tax policy. ERTA is nothing less than a first attempt to slow the increase in the federal government's share of our Gross National Product.

Prior to the passage of ERTA, it was estimated that the federal government would claim more than 21% of GNP in the years 1981-1985, and a continuously rising share thereafter. By reducing marginal tax rates for individuals by 25% over three years, the government's claim of GNP was reduced to an estimated 17.4%, and after adjustments via the highway gasoline tax and the Tax Equity & Fiscal Responsibility Act of 1982 (TEFRA), to about 18.6% of GNP.

One of the most significant features of ERTA is the provision for the annual indexing of individual income tax brackets, the zero bracket, and the personal exemption in accordance with rises in the consumer price index for urban households, to begin in calendar year 1985.

Indexing is tax technique which is long overdue. It is the best means by which to relieve the invisible tax of inflation on lower and middle-income taxpayers available to this Administration and this Congress. Indexing the tax basis of capital assets would eliminate the unfair and prejudicial effects of current law.

Indexing will force the Congress to confront head-on the underlying economic conditions which necessitate its use. Once indexing is in place, Congress will either have to approve continuous and regular tax increases, something inflationary bracket creep has allowed them to avoid, or fight the inflation that the nation will again inevitably face in response to horrendous budget deficits projected for the rest of this decade. As USBIC has stated many times, inflation can be purged from our economy only by substantial reductions in federal spending, particularly spending on entitlements. There can be no doubt that the widespread support for indexing is an expression of the American peoples' deep dissatisfaction with Congressional failure to reduce deficits without visiting inflation on the economy.

In view of the widespread support for indexing, and given its obvious benefits, it is difficult to understand how it can be opposed on economic grounds. ERTA was approved by the U.S. House of Representatives on July 29, 1981 by a decisive vote of 238-195, with 48 democrats voting for the President's bill. Yet today, just two years later and 17 months before indexing is to take effect, it is facing strenuous opposition.

USBIC believes that the basis for efforts to repeal indexing, and resistance to the idea of extending indexing to capital gains, is an unwillingness to accept fiscal discipline by the Congress.

Indexing is a means to ensure that real tax revenues are consistent with real economic growth. To the extent that nominal capital gains represent simple inflation in asset values, no additional real capital is created and taxation of those gains erodes our capital base. We must index the basis of productive assets so that the inflation component will not be subject to tax.

If revenues to the U.S. Treasury are restricted to the actual growth in the nation's economy, rather than the fictional growth attributable to inflation, the beneficiaries of inflation, Congress and the carnival of special interests tied to entitlements and other largesse, would become accountable to the tax payer once again. It is no wonder that the opponents of indexing resort to the red herring of larger budget deficits between 1985-1988. (claims have been made of an additional $90 billion in the deficit for this period if indexing goes into effect)

Doomsday talk of higher and higher deficits is the first tactic of the tax-and-spend advocate. Big deficits will indeed be a serious problem for the U.S. economy for at least the rest of this decade, but deficits happen not because the government fails to collect sufficient revenue, but because it continues to spend too much.

Even at that, deficits are directly related to economic growth. We have just seen our economy grow at a rate of 8.7% for the second quarter of 1983, the strongest pace since the 1st quarter of 1981. The Office of Management & Budget has lowered its projections of the deficit for fiscal 1984, from $190.2 billion to $179.7 billion, as well as for the out-years through 1988.

USBIC believes that real economic growth is the best hope for ameliorating the deep and traumatic economic problems caused by the recession of 1981-82. We believe that real growth can only be sustained if consumers, producers, and investors are confident that the labor they perform and the risks they take, in short, enterprise, will not be penalized by the hidden tax of inflation.

Tax reduction, the centerpiece of ERTA, is the only effective means available to the American people by which to impress upon Congress the need to reduce federal spending. Without ERTA's indexing feature, and without the extension of this approach to capital gains, federal revenues will continue to increase from bracket creep, notwithstanding the recent tax reduction features enacted by Congress. This is the legacy of inflation, as well as the greatest economic threat for America's future.

USBIC concurs with Senator Armstrong that the Consumer Price Index is an unreliable measure of inflation in its present form. There is a consensus among economists that reference to the GNP-deflator would be a more accurate index.

USBIC, therefore, specifically endorses the indexation of the tax on capital gains to the GNP-deflator.

We commend Senator Armstrong and other members of this Committee for their iniative in this area of economic policy and thank you for inviting USBIC to express the views of its members in this forum.

STATEMENT OF MARK A. BLOOMFIELD, EXECUTIVE DIRECTOR, AMERICAN COUNCIL FOR CAPITAL FORMATION, WASHINGTON, D.C.

Mr. BLOOMFIELD. Mr. Chairman and members of the committee, I am Mark Bloomfield, the executive director of the American Council for Capital Formation. I am pleased to be here today to urge enactment of S. 1600 introduced by Senator Armstrong, which would index the basis of capital gains for inflation and address a very real problem in the taxation of capital, that is, the mismeasurement resulting from inflation.

Mr. Chairman, tax policy is a primary vehicle through which the Government can dramatically affect capital formation, the saving and investment necessary to stimulate productivity growth, restore real income gains, and provide for job creation.

Congress took a dramatic step forward in procapital formation tax policy in 1978 when it reduced the excessive taxation of capital gains. Skeptics at that time said it would do little for capital formation and it would do much to erode Government revenues. On both counts they have been proved dead wrong. First, the economics. We have two historical periods to compare. There is the period 1969 to 1977, where we had increasingly higher capital gains and a bad investment climate. There is the period subsequent to the 1978 capital gains tax cut to the present, where we had lower capital gains and a better investment climate. What happened? In the latter period, venture capital, new stock offerings, the value of corporate equities blossomed. Why? We again restored the reward for risk taking and investment.

Now what about Uncle Sam's coffers? The Government predicted in 1978 that there would be a $2 billion raid on the Treasury. What happened? After 1978 when tax rates were reduced, revenues went up. Actual taxes paid on capital gains were up by more than $2 billion in 1979, the first year of the lower capital gains rate. Up again in 1980, and in 1981, actual revenues from capital gains were still substantially higher than in 1978, the last year of the old lower rate.

Economists, however, also compare actual revenues with what would have happened if the tax laws had not been changed. In a January 1983 paper commissioned by the ACCF: Center for Policy Research prepared by Dr. Jerry Auten, a former Treasury consultant on capital gains, capital gains taxes actually paid under the new law were compared with taxes that would have been paid under the old law. What did Dr. Auten find? He found that in 1979 revenues were more than $1 billion higher; in 1980, almost $2 billion higher; and in 1981, again over $1 billion higher than they would have been under the higher old capital gains rate. Given the benefits to capital formation also to Uncle Sam's Treasury, much more needs to be done. We still tax capital gains much more harshly than our major industrial rivals. Much needs to be done, including S. 1600. S. 1600 is long overdue because it would insure that tax would be paid on real, not inflated, capital gains.

Dr. Martin Feldstein, the current Chairman of the Council of Economic Advisers, in a 1978 study, found that in 1973 Americans actually paid taxes on more than $4.5 billion of nominal gains. But after adjusting the nominal gains for inflation, these Americans paid taxes on nearly $1 billion of losses. In his 1983 study, Dr. Jerry Auten found that taxpayers paid taxes on $25 billion of nominal gains from stock transactions between 1971 and 1975. But after adjusting for inflation, these taxpayers paid taxes on $420 million of losses, with the problem most acute for taxpayers in low- or middle-income categories. Enactment of S. 1600 is good tax policy for three reasons. First, at a cost of very little additional complexity, real tax rates would be in line with intended statutory ones. Second, while there is good news on the inflation front, the battle against inflation is far from over. And inflation at even modest levels causes capital gains to be mismeasured. And, third, since the critics were dead wrong about the revenue impact of the 1978 capital gains tax cut, I suggest that the revenue numbers that were cited earlier by the Treasury Department could also be wrong, and that S. 1600 could raise revenues rather than lose them.

I would also like to add that S. 1600 is only one of a number of measures we support to move our country in the direction of a zero tax on capital gains. Other items to be considered include reducing the holding period, bringing the corporate rate down to the maximum rate for individuals, and, finally, reducing rates for both individuals and corporations further.

Senator ARMSTRONG. Thank you very much. It was an especially interesting statement and I am grateful for the statistical documentation that you have provided. I have underlined some portions of your statement that I am going to try to bring to my colleagues' attention as forcefully as I can.

[The prepared statement of Mr Bloomfield follows:]

Statement of Mark A. Bloomfield, Esq.,
Executive Director, American Council for Capital Formation
before the
Subcommittee on Taxation and Debt Management
of the
Senate Committee on Finance

August 1, 1983

Mr. Chairman, and Members of the Committee, my name is Mark A. Bloomfield. I am the Executive Director of the American Council for Capital Formation. I appreciate the opportunity to present the views of the American Council on S. 1600. Introduced by Senator William L. Armstrong, S. 1600 would index the basis of certain assets, primarily corporate stock and real property, for inflation.

The American Council for Capital Formation is an association of individuals, businesses, and associations united in their support of government policies to encourage the productive capital formation needed to sustain economic growth, reduce inflation, restore productivity gains, and create jobs for an expanding American work force.

Mr. Chairman, officers of the American Council have appeared often before your Committee over the years as you studied legislation affecting saving and investment. We applaud the efforts of this Committee in bringing to the attention of your Congressional colleagues and the American public the critical relationship between capital formation and economic growth. This Committee has played a leadership role in the development of legislation to set the stage for renewed growth in productivity, real income gains, and expanded job opportunities.

We are pleased to appear before you again in support of legislation we deem vital to capital formation. S. 1600, introduced in the first session of the 98th Congress by Senator Armstrong, and its companion bill in the House of Representatives, H.R. 3651, introduced by Congressman Bill Archer, address a very real and continuing problem in the taxation of capital--the mismeasurement resulting from inflation. By indexing the basis of certain capital assets, S. 1600 and H.R. 3651 provide a solution to this problem in an equitable and efficient manner.

The Need for Greater Capital Formation

Past government policies, especially tax policy, have discriminated in favor of consumption and against saving and investment, thus slowing the rate of capital formation. In addition, since the pretax return to capital investment exceeds the aftertax return, the level of capital formation is lower than it would otherwise be. Yet, the experts tell us that increased capital formation can reverse some of the slowdown in productivity experienced in the United States over the last decade.

Productivity growth fell rapidly during the 1970's. Between 1948 and 1967, the growth rate of productivity (as measured by output per hour in the private business economy) was 3.1 percent, compared to 2.3 percent between 1967 and 1973 and only 0.3 percent between 1973 and 1981.

The consequences of reduced productivity growth for our standard of living over the long run are great. As an example, in 1981 the American economy produced approximately $12,780 worth of output per capita. Had productivity growth continued at the 1948-67 rate for the following fourteen years, output per capita would have reached $16,128 in 1981, 26 percent higher than its actual value.

There are many causes for the slowdown in productivity growth since 1965. Higher energy prices, regulatory changes, lagging research and development spending, reduced opportunities for technical innovation, the changing composition of the labor force and changing worker attitudes, as well as reduced capital formation, are responsible for the decline in productivity growth. Many of these causes of the slowdown cannot be reversed through government policies. Certainly, the government is limited in what it can do to influence cultural attitudes toward work. Likewise, the government could not have done much to offset the rise in energy prices. Changing the rate of capital formation may well be the principal way in which Federal economic policy can affect productivity growth.

Tax policy is a primary vehicle through which Federal policies can dramatically affect capital formation. The individual income tax extracts a portion of the total return to the investor and the corporate tax reduces the return that corporations receive on new investments. As a consequence of this tax-induced divergence between private and total return to investment, too little investment takes place. This suggests that measures both to reduce the anti-capital tax bias and to increase incentives for saving and investment are needed.

Results of Recent Cuts in Capital Gains Taxes

Prior to 1969, there was a long period of relatively favorable long-term capital gains tax treatment; in 1969, however, major increases in capital gains taxes were considered and enacted. Throughout the 1969-1977 period, additional tax changes were made which were unfavorable for investors.

A dramatic shift toward pro-capital formation tax policy occurred in 1978 when Congress reduced the excessive taxation of capital gains which was inhibiting saving and investment. That year, the maximum capital gains tax was cut from 49 percent for individuals (including the interaction of the old maximum and minimum income taxes) and about 31 percent for corporations (including the minimum tax) to 28 percent for both.

The 1978 capital gains tax reduction was the first of a series of changes which progressively reduced tax rates on individual capital. Other important steps include the reduction in the top rate on investment income from 70 to 50 percent, which eliminated the distinction between earned and unearned income, the expansion of Individual Retirement Accounts, the lowering of estate taxes, and the 25 percent reduction in marginal income tax rates in 1981-83 which also reduced tax rates on investment income and capital gains. The top tax rate on long-term capital gains has thus been reduced from just under 50 percent to 20 percent.

These recent changes in the U.S. tax Code brought the taxation of capital gains closer to that of our international competitors. However, our capital gains tax rates and holding period requirement to qualify for long-term capital gains tax treatment are still relatively harsher than those of most of the major industrialized countries. Table I attached gives international comparisons in the taxation of capital gains.

Early in the 1978 debate on the need to cut capital gains taxes, skeptics said that such measures would do little for capital formation and would erode government revenues. However, since 1978, considerable evidence of the salutary effects of reductions in taxes on capital gains has been documented.

First, since lower capital gains taxes increase the rewards for risk taking, it is understandable that those investment activities that involve the most risks, such as venture capital investment, would feel the sharpest impact of the change. In fact, the amount dedicated to organized venture capital investment entities expanded from an average of $70 million per year in the years 1969 through 1977 to an average of just under $1 billion per year in the years 1978 through 1982, with total dedications of $1.3 billion in 1981 and $1.7 billion in 1982. This is the nation's seed capital, from which hundreds of new companies are started each year.

Second, the performance of the equity markets has improved substantially. The nine-year depression in equity values which began in 1969 when tax rates on individual capital were raised significantly ended early in 1978, when the trend toward lower taxes on capital began. Since the end of 1977, the value of corporate equities at market has risen 83 percent; over $820 billion has been added to this value. Other economic factors have most certainly been responsible for some of the recent increase, including the improved outlook for lower inflation, lower interest rates, and prospects for economic improvement. Yet gains throughout 1978-80 took place in spite of worsening inflation and rising interest rates. The common thread throughout the period has been the progressive reduction in tax rates on individual capital.

Third, new capital raised through initial public stock offerings climbed out of a lengthy depression in late 1978, and dramatic gains took place in 1979-81. Due to a less favorable stock market during much of 1982, there was some fall-off in that year, but offerings picked up sharply toward its close, and in the first six months of 1983.

Initial and periodic infusions of equity capital are critical for the successful development of new, young, and rapidly growing companies and for their capacity to generate new job opportunities. But many mature and large companies need to raise additional amounts of equity capital as well. The lengthy depression in equity values from which we are now emerging forced many companies to rely heavily on debt, particularly short-term debt. If these companies can replace some of this debt with equity, they will be in a better position to expand their facilities and their work forces as business improves. To the degree that the sale of equity can replace debt and meet the new financing requirements, some of the upward pressure will be taken off both short- and long-term interest rates which would further brighten the prospects for recovery.

Finally, opponents of lower capital gains taxes argued in 1978 that the reduction would cost the Treasury over $2 billion in revenue. The facts show that taxes paid on capital gains increased from $9.3 billion in 1978 to $11.5 billion in 1979, to $12.2 billion in 1980, and $11.6 billion in 1981.

In addition, economists have prepared simulations comparing the taxes actually paid with the taxes that would have been paid under the old law. Recent research by Dr. Gerald E. Auten, a Treasury Department tax policy consultant, in a paper commissioned by the American Council for Capital Formation: Center for Policy Research, compared the capital gains taxes actually paid under the new law with taxes that would have been paid under the old law.1/ Dr. Auten's results

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1/Auten, Gerald E., "The Taxation of Capital Gains: An Evaluation of the 1978 and 1981 Tax Cuts for Capital," New Directions in Federal Tax Policy for the 1980's (Cambridge, Massachusetts: Ballinger Publishing Company, forthcoming).

indicate that under the new law, capital gains tax revenue was $1.2 billion higher in 1979, $1.8 billion higher in 1980, and $1.3 billion higher in 1981 than it would have been in the absence of the capital gains tax reductions.

The evidence thus far also indicates that so-called "fat cats" are paying more capital gains taxes than ever before. Those with incomes over $100,000 included $11.7 billion of net capital gains in adjusted gross income in 1979, an increase of 72 percent over the $6.8 billion reported in 1978. IRS data show the net gain included in income rose to $12.7 billion in 1980 for the high income group.

These facts make a convincing case in favor of reductions in capital gains taxes. But, have we gone as far as we can to ensure the maximum benefit to the American economy from such tax reductions? In our judgment, the answer is "no."

The Next Step

Recognizing the critical nature of the capital gains tax, the American Council for Capital Formation has long advocated a full range of legislation designed to reduce this tax. Much now remains to be done, including indexing the basis of capital assets for inflation, reducing the holding period for long-term capital gains, cutting the corporate capital gains tax rate of 28 percent so that it is equal to the maximum rate for individual capital gains, and further reducing the capital gains tax rate for individuals and corporations.

We commend Senator Armstrong and Congressman Archer for their initiative in introducing legislation to offset the effects of inflation on capital assets. We congratulate Senator Armstrong on his successful effort on the Senate Floor in 1982 to amend the Senate Finance Committee version of the Tax Equity and Fiscal Responsibility Act to include his provision to index the basis for capital gains.

The Armstrong-Archer bill is long-overdue for enactment. Inflation distorts the taxation of capital gains as well as other forms of capital. Inflation is particularly harsh in its impact on capital gains because it distorts not only the real values of the tax brackets and exemptions, but also the measurement of both capital and income. Capital mismeasurement occurs when a taxpayer purchases in one period and sells in another. He has real capital gain only if the transaction leaves him "better off." Properly measured, the capital increment should be the amount by which sales proceeds exceed the amount required to "stay even."

If the taxpayer purchases an asset for $100 and sells after there has been 20 percent inflation, he must receive at least $120 to stay even. Only the excess over $120 is real income. But for tax purposes, capital gain is mismeasured as the excess over $100, notwithstanding that the first $20 of any excess is not real, but illusory.

If the illusory gain is large compared with the real gain, the effective tax rate can be multiplied many times over. If, for example, the illusory gain is four-fifths of the total gain--as would be the case if the property in the example above were sold for $125--the capital gain would be overstated five times. The taxable capital gain would be $25 but the real gain would be only $5. The result is the same as if the tax rate were multiplied by five. A 20 percent capital gains tax rate becomes effectively 100 percent.

Research on nominal and real capital gains for assets sold between 1971 and 1975 shows that the effect of taxing nominal gains is to increase substantially the effective tax rate on real capital gains. Dr. Auten's study of the results of the 1978 and 1981 capital gains tax reduction analyzed nominal and real capital gains on corporate stock over income classes and found that, for assets sold between 1971 and 1975, the $25 billion of nominal capital gains on stock sold in this period actually represented a loss of $420 million after adjusting for inflation.2/ His study also showed that the problem was most severe for taxpayers in lower and middle income categories. The real capital gains of taxpayers with adjusted gross incomes over $500,000 were more than 80 percent of their nominal gains. However, taxpayers with incomes under $50,000 had nominal gains but substantial losses in real terms. Table II attached illustrates these effects.

2/Ibid.

Dr. Auten's analysis also showed that although it might be expected that these inflation induced real losses would be greatest for long-held assets, this is not the case. The real losses are concentrated in stocks held less than five years, while the longer held stocks had net positive real capital gains. He noted that this is because of the higher rates of inflation in recent years as compared to earlier years.

Dr. Auten's findings are similar to those of Dr. Martin Feldstein, now chairman, President's Council of Economic Advisers.[3] Dr. Feldstein, in a 1978 study for the National Bureau of Economic Research, showed that in 1973 individuals paid nearly $500 million of extra tax on corporate stock capital gains because of the distorting effect of inflation. His study also found that this distortion was greatest for middle income sellers of corporate stock. Specifically, the study showed that in 1973 individuals paid capital gains tax on more than $4.5 billion of nominal capital gains on corporate stock. If the costs of the shares were adjusted for increases in the consumer price level since they were purchased, the $4.5 billion nominal gain became a real capital loss of nearly $1 billion. Dr. Feldstein noted that as a result of this incorrect measurement of capital gains, individuals with similar real capital gains were subject to very different total tax liabilities.

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[3] Feldstein, Martin, and Joel Slemrod, "Inflation and the Excess Taxation of Capital Gains on Corporate Stock," National Bureau of Economic Research Working Paper #234, February 1978.

The Armstrong-Archer bill would remove the inflation tax by adjusting the basis of certain assets for inflation. The bill would apply prospectively to most corporate stock and real property.

Critics contend that enactment of the Armstrong-Archer bill would increase the complexity of the tax law. It is true that indexing involves some additional complexity but the Armstrong-Archer bill reduces any potential complexity by applying only to corporate stock and real property exchanged or sold, and not for the purposes of determining depreciation, cost depletion or amortization. Debt is completely excluded from the inflation adjustment. Thus, at the cost of a little additional complexity, real tax rates can be brought back in line with intended statutory rates and all savers, wealthy and nonwealthy, can be protected from taxes that might well consume all their investment income plus a part of their principal.

Critics also charge that with the current lower inflation rates, the need for indexation is lessened. While it is true that there is good news on the inflation front, the battle against inflation is far from over, with at least moderate rates of inflation expected in the near future. In addition, inflation even at moderate levels will cause capital gains to be mismeasured. A true measurement of capital gain is needed to minimize distortions and misallocations.

The need to staunch further outflows of Treasury revenue from tax cuts is also offered as an argument against enactment of the Armstrong-Archer bill. However, the critics were dead wrong about the revenue costs of earlier cuts in capital gains taxes. It is likely that the revenue estimators will be wrong again and the Armstrong-Archer bill will generate revenue gains, not losses, as investors find the climate more favorable for capital formation. Even if there were some modest revenue loss, the Treasury will simply be losing revenue to which it is not entitled, that produced by unintended multiplication of statutory rates.

Conclusion

The Revenue Act of 1978 ushered in a new era in the taxation of capital gains. Passage of the Armstrong-Archer bill is a next logical step in that direction. The measure would ensure that only real gains from corporate stock and real property are taxed. It would add substantial equity and efficiency to the taxation of capital gains and eliminate the taxation of nonexistent profits. The revenue loss from the measure would be small at worst, and, at best, might generate revenues just as did the 1978 capital gains tax cut.

The time is right. We urge this Committee to once again take the lead with this innovative measure. Optimal growth in productivity will not be forthcoming under a tax system that mismeasures increases in capital and thus consumes the potential returns from investment.

TABLE I

COMPARISON OF INDIVIDUAL TAXATION OF CAPITAL GAINS ON PORTFOLIO STOCK INVESTMENTS IN ELEVEN COUNTRIES

Country	Maximum Short-Term Capital Gain Tax Rate*	Maximum Long-Term Capital Gain Tax Rate*	Minimum Holding Period to Qualify for Long-Term Gain Treatment	Maximum Annual Net Worth Tax Rate
United States	50%	20%	One Year	None
Australia	60%	Exempt	One Year	None
Belgium	Exempt	Exempt	None	None
Canada	17%**	17%**	None	None
France(1)	15%	15%	None	None
Germany	56%	Exempt	Six Months	.5%
Italy	Exempt	Exempt	None	None
Japan	Exempt	Exempt	None	None
Netherlands	Exempt	Exempt	None	.8%
Sweden	54%	22%	Two Years	3%
United Kingdom(2)	30%	30%	None	None

* State, provincial and local taxes not included.

** Provincial taxes in Canada approximate a 48% add on to federal tax.

(1) Gains from proceeds of up to $20,445 (FF 150,000) are exempt from taxation in a given taxable year.

(2) The first $7,725 (£ 5,000) of gain is exempt annually.

SOURCE: "Comparison of Individual Taxation of Long and Short Term Capital Gains on Portfolio Stock Investments and Dividend and Interest Income in Eleven Countries," prepared for the Securities Industry Association by Arthur Andersen & Co., June 1983.

TABLE II

NOMINAL AND REAL LONG-TERM CAPITAL GAINS, 1971-1975

Income Class AGI in $1000s	Number of Returns With Gains	Nominal Gains	Real Gains	Real Gains By Holding Period			
				1-5	5-10	10-20	Over 20
		(millions of dollars)					
Corporate Stock Sales							
Negative AGI	87,887	186	-192	-209	-43	26	34
$ 0 - 20	5,803,695	5,444	-3,792	-2,799	-2,920	-887	2,813
$ 20 - 50	3,867,614	3,086	-4,546	-4,576	-362	266	126
$ 50 - 100	803,178	4,504	1,012	-1,961	2,184	379	411
$100 - 200	214,048	2,580	369	-1,434	420	672	713
$200 - 500	47,011	3,309	2,083	-298	1,265	680	437
$500 and Over	10,109	5,533	4,642	-22	2,289	1,305	1,070
Total	10,833,542	24,622	-420	-11,287	2,832	2,440	5,603
Real Estate							
Negative AGI	53,146	434	112	-29	126	9	6
$ 0 - 20	1,032,134	3,544	1,120	397	-71	204	589
$ 20 - 50	587,988	6,875	2,994	1,478	-61	85	1,493
$ 50 - 100	85,539	1,148	528	78	200	85	165
$100 - 200	29,771	740	297	208	61	71	-44
$200 - 500	7,483	359	163	59	25	95	-16
$500 and Over	1,181	121	82	10	24	27	19
Total	1,797,242	13,250	5,295	2,201	305	577	2,213
Residences							
Negative AGI	8,849	2	-66	-7	-3	-14	-43
$ 0 - 20	601,767	1,435	-1,623	-406	-481	-441	-295
$ 20 - 50	259,745	1,239	-1,048	-96	-405	-255	-293
$ 50 - 100	17,162	285	-19	7	16	-102	60
$100 - 200	7,458	131	-18	20	6	-28	-18
$200 - 500	1,540	21	-10	2	7	-17	-2
$500 and Over	651	3	-.5	1	-.5	-.1	-1
Total	896,772	3,115	-2,785	-478	-859	-857	-591
Other Transactions							
Negative AGI	96,695	606	395	101	104	25	165
$ 0 - 20	1,184,786	3,673	1,972	634	734	418	186
$ 20 - 50	535,878	5,045	3,402	1,002	659	229	1,513
$ 50 - 100	129,315	1,291	643	282	70	270	20
$100 - 200	35,387	864	479	228	126	118	7
$200 - 500	8,622	397	82	44	-45	75	8
$500 and Over	1,333	174	86	38	32	13	3
Total	1,992,616	12,049	7,058	2,329	1,679	1,147	1,901

urce: Auten, Gerald E., "The Taxation of Capital Gains: An Evaluation of e 1978 and 1981 Tax Cuts for Capital," New Directions in Federal Tax Polic the 1980's, (Cambridge: Ballinger Publishing Co., forthcoming).

Senator **Armstrong**. Let me go back to Mr. Lerner. Your constituents, the Certified Public Accounts of the country, are more directly involved in the day to day preparation of tax returns than anybody, I guess. And so I presume that you are in a position to respond to the issue raised by the Treasury about the complexity of this proposal. That seems a bit thin to me, but I wonder, from your standpoint, representing the majority of the tax practitioners in the country, how do you feel? Is this going to introduce an unduly complicated provision in the law? And how does it compare with what else is already in the law?

Mr. **Lerner**. Well I think it is fair to say, Mr. Chairman, that the present tax system is a fairly complicated aggregate of legislation and change in itself is complicated. But it is important to bear in mind the importance of reflecting a more rational, more equitable system of taxation in this country. And we are convinced that indexation is the necessary ingredient to achieving that level of equity. In terms of its implementation, we have studied this matter at great length, and have concluded that whatever increased complexity any change would bring to bear in this area is a worthwhile level of increased complexity. If you, for example, key the index factor to one readily understood, and published a factor for applying to the adjusted base of an asset to determine the amount in calculating the inner loss, we think that that is an acceptable level of complexity. So on a balanced judgment, we are convinced that indexation of the base in a substantially similar way to the way that we index the rate structures as a desirable goal.

Senator **Armstrong**. In other words, you just feel it is manageable. It is not a problem that your people couldn't cope with in advising their clients.

Mr. **Lerner**. That is right.

Senator **Armstrong**. I was intrigued by your observations about indexing depreciation. Obviously that is not covered in this bill, and there are some good reasons why it is not. But I thought your observations were very interesting and thoughtful. I am well aware that in certain basic industries it is believed that a large part of the declining ability of industries like steel to compete with foreign producers is precisely the depreciation policies that we have had over the last 20 years or so in this country. I am not sure I understand exactly what you mean by indexing the depreciation basis, however. And I don't want to precipitate a lengthy discussion of it because we have got an awfully long list of witnesses, but could you elaborate on that just a little? Are you saying that, in effect, someone could depreciate more than his actual investment in a fixed asset, or are you simply saying accelerate the time for taking the deduction?

Mr. **Lerner**. No. Well it could go either way. It depends on how it were adopted. But to be consistent and to have the notion that nominal dollars are not the appropriate test for applying our views in connection with our tax system, then the $1,000 invested 10 years ago, if measured in today's dollars, should produce a recoverable basis in excess of $1,000. Otherwise, you are, in effect, taxing capital. So it is clear that conceptually the aggregate deduction exceeding the original cost is appropriate on an index system for dealing with depreciation or cost recovery.

Senator **Armstrong**. In other words, you are saying that if I am a widget manufacturer and I have got a widget making machine, I ought to be able to charge against income a sufficient amount so that by the end of the useful life of that machine I have got enough cash in hand, or at least have deducted enough cash, to buy a comparable new widget manufacturing gadget?

Mr. **Lerner**. That is absolutely so in inflationary periods. Let's assume, for example, that it doubled in that period. Then $2,000 would be necessary to replace that widget machine, and theoretically recovery of $2,000 would be necessary to preserve the capital base for future operations.

Senator **Armstrong**. I would like to think about that, and perhaps we can consult on it privately. Instinctively, I don't think I can sell that idea to my colleagues just yet. I am not sure I am ready to buy it myself, but I am interested in it. It addresses itself to a terribly serious problem which really has distorted the economic performance of our country. And I thank you for raising it this morning.

Mr. Jonsson, I also want to compliment you. I noted that your statement went right to the heart of the reason why there is so much opposition to the indexing of personal tax brackets. And I thank you for raising that. I would also like to ask you to respond to something the Treasury Department said earlier. The Treasury Department's testimony in effect included a sort of a catch-22 line of opposition. They said, on the one hand, they could not support this legislation because it only specified certain assets to be indexed. It did not take care of everything. On the other hand, if a bill were brought forward that took care of everything—it indexed all assets—they could not support that, because that would be so costly that we just could not afford it. And so it is a sort of a catch-22.

From the perspective of the 3,000 members of your organization who, as I understand it, are senior corporate executives, how do you suppose they would react to that? Would they be disposed to take a step, in other words, solve part of the problem, or would they feel that it would create additional distortions to index one group of assets but not others? Do you have any feel for that? I suppose this isn't something you have chatted with them about, but how do you suppose they would react to that?

Mr. **Jonsson**. Well, I do have a feel for that, Senator. And I believe that they would approve of the step by step approach, recognizing the political difficulty associated with trying to comprehensively reform the tax code. It is extremely difficult to get a whole loaf of bread, and it is much better to get half a loaf if it is a good product. And I think in this case it is a product that they understand. It makes sense for tax policy, it makes sense for fiscal policy, and it certainly will help them in being better able to retain capital.

Senator **Armstrong**. From the perspective of these corporate executives who I take it are actually the, in some cases, the chief executive officers, and in other cases, are senior managers of these companies, is it your judgment, from talking to them, that legislation of the kind we are talking about might unlock assets that are, in effect, frozen? Is that something that I could realistically hold out as an inducement to my colleagues that there would be a turnover in some of these assets, and that money would be redeployed into more productive——

Mr. JONSSON. I think that is a realistic assumption.

Senator ARMSTRONG. I am sure you don't have any way to measure that.

Mr. JONSSON. Certainly on the part of independent businesses, closely held firms.

Mr. BLOOMFIELD. Mr. Chairman, if I could interject.

Senator ARMSTRONG. Yes. Please do.

Mr. BLOOMFIELD. The gentleman made reference to Dr. Feldstein's recent study. Dr. Feldstein looked at what happens to reported net long-term capital gains, and he found that the reported net long-term capital gains more than doubled between the year 1977, the year before the tax changed, and 1979. So that is a doubling of net long-term capital gains. And, ironically, with regard to the argument that some people may——

Senator ARMSTRONG. Now are you saying that that is related to the change in the capital gains tax rate?

Mr. BLOOMFIELD. Yes.

Senator ARMSTRONG. I thought that was the point you were making earlier, and I want to nail that down. I believe that you are correct about that, and I want to thank you for raising that issue.

Mr. BLOOMFIELD. But those are very specific numbers that he actually found and are included in his study.

Senator ARMSTRONG. Mr. Bloomfield, could we talk a little more about that? You make the observation on page 3 of your statement, "Tax policy is a primary vehicle through which Federal policies can dramatically affect capital formation." If you were going to characterize in a few words the general attitude of Federal tax policy or the general effect of Federal policy towards capital formation in recent years, what would you say it was? Has it been generally favorable the last 20 years to the formation of capital or generally unfavorable?

Mr. BLOOMFIELD. I would submit until the changes that started with the capital gains tax cut in 1978, our tax system was biased against saving and investment, more so than most other major industrial countries. And you can focus on specific tax issues, whether it be through double taxation of corporate profits, or capital gains taxation, or savings incentives such as IRAs and Keoghs. What we have done since 1978 is incrementally eliminated some of those biases in our tax system against saving investment. But you will find, for example, if you look at the international comparisons on table 1, in my written testimony that with regard to capital gains, we still tax capital gains much more harshly than our competitors. And tax policy I think is one way that you can affect capital formation. It is a lot easier to do it through tax policy than through changing people's attitude toward work and saving. Although I think things can be done in that regard, too. In short, tax system is biased against saving investment. We penalize saving and work.

Senator ARMSTRONG. Your organization, as I understand it, exists primarily to support those policies that will encourage capital formation, the investment of capital in productive enterprises. From that perspective, let me ask you the lock in question, the same question that I put a moment ago to Mr. Jonsson. Is it your view that indexing this group of capital assets that are referred to, indexing the basis, would in fact cause some of those assets to be sold off, and the proceeds reinvested in more productive assets? In other words, would it improve the overall efficiency of the economy?

Mr. **Bloomfield**. I think it would. I think we have found that with a substantial reduction in capital gains taxes in 1978, most of that additional revenue that I mentioned, which are not my numbers—those are official Treasury numbers—much of that additional revenue in 1979, 1980 and 1981 came from the unlocking.

Now essentially what your proposal does is to further reduce the capital gains tax burden for a taxpayer. And I made the comment in my statement that even though we are fighting and perhaps winning the battle of inflation, we still will have moderate rates of inflation. Let me just very quickly give you an example which illustrates that even with moderate levels of inflation the tax burden goes up tremendously. Assume an asset costs $100 and the sales price is $125. The tax rate is 20 percent on capital gains. Assume a 6 percent inflation rate. In the example I gave you, if an investor holds that asset one year before he sells it, his tax rate will not be the statutory one of 20 percent but it will be 26 percent. After 2 years, his effective capital gains tax rate will be 39 percent; after 3 years, 71 percent. You can see how you very quickly return to the confiscatory tax rates that existed before the 1978 capital gains tax cut. And the unlocking that I made reference to which resulted in the revenue gains in 1979 and 1980 will be restored.

Senator **Armstrong**. Well I am very grateful for your observations, and I appreciate so much the appearance of all of the members of the panel. Mr. Bloomfield, before we move on—and I must do so because we have a lengthy list of witnesses—I just want to observe, in passing, that while it is not the subject of this hearing at all, I share your enthusiasm for the changes in the holding period and the marginal rate reduction. Some people have the idea somehow that because we had the tax cuts that that task is over and that it will be another generation before we come back to it. And I sure hope that is not the case. Thank you very much.

S. 1579—CHARITABLE DEDUCTION FOR MILEAGE

Mr. **Armstrong**. The next bill on todays hearing agenda is S. 1579, Charitable Deduction for Mileage legislation.

We are now pleased to welcome a panel consisting of Sandra Crawford, director of public policy, the Association of Junior Leagues, from New York; Mr. Joseph Miller, assistant director of the American Legon; and Mr. John Chromy, a member of the board of directors of Volunteer, the National Center for Citizen Involvement, in Washington, D.C. These panelists are here to testify on the subject of S. 1579, the Charitable Deduction for Mileage, or, as my colleague, Representative Mikulski, pointed out, "The Good Samaritan Mileage Deduction bill." Miss Crawford, would you begin please? We are very pleased to have you with us and are looking forward to your testimony.

[The prepared statement of Senator Armstrong follows:]

STATEMENT OF SENATOR ARMSTRONG

Is the government making volunteerism a luxury that few Americans can afford?

The answer, I regret to say, is yes.

I have introduced Good Samaritan legislation to reverse this policy.

The facts are indisputable. Though social needs are greater than ever, fewer and fewer Americans are financially able to deliver meals to shut-ins, visit the sick, take Scouts on camping trips, drive a cancer-stricken child to daily treatments, or help conduct the local Special Olympics.

This decline is at least partly the fault of federal tax policy which prevents proper reimbursement for volunteer costs. Although costs of owning and operating a car exceed 24 cents a mile, volunteers can deduct from their taxes only nine cents for each volunteer mile driven, or about one-third of the actual costs.

The result? Americans can no longer just volunteer; they have to pay to volunteer.

The Good Samaritan Volunteer Mileage Bill I have just introduced will correct this problem. It is simple. Volunteers would be able to deduct the same mileage costs as businessmen and government workers, who use cars in their work—20 cents a mile.

The justice of this bill is clear. Consider the following cases:

A state volunteer director attends a week-long volunteer convention in Florida. As long as most of the day is spent in volunteer meetings, the trip—airfare, meals, lodging, sightseeing, etc.—is fully deductible. When the director returns, and resumes work driving about the state coordinating volunteer activities, only nine cents a mile is deductible.

A Salvation Army volunteer who comforts the sick can deduct only nine cents a mile for driving to the hospital. Yet a salesman calling on that same hospital to sell medical supplies not only earns a salary but deducts 20 cents a mile from his federal tax return.

A Red Cross volunteer reporting to a disaster shelter during a flood is allowed by the federal government to deduct only nine cents a mile to get there. Yet a paid employee of the Federal Emergency Management Agency is reimbursed 20 cents a mile to drive to the same shelter.

Neighbors band together to establish neighborhood citizen watches to patrol their streets. They can deduct only nine cents a mile, but a security guard hired to partrol the same neighborhood can deduct 20 cents a mile.

The chairman of the Denver chapter of the American Red Cross each year drives more than 2,300 volunteer miles. Though he is allowed a deduction of only nine cents a mile, the actual cost for owning and running his car exceeds 25 cents per mile.

More than 92 million Americans volunteer their time, services, skills and cars to help the needy, the victims of natural disasters, the homeless, the sick, the imprisoned, the homebound. The total value of these services exceed $64 billion, according to the Gallup Organization.

These volunteers are essential to our national well-being. Without them, there is a real question about whether our less fortunate could even survive. Neighbors helping neighbors is an American tradition; it is something that the federal government should encourage, not tax.

But volunteerism is becoming a luxury that too many Americans can no longer afford because federal policy is horribly out of date.

The volunteer mileage deduction became law in 1958. Then the deduction was seven cents a mile, gasoline sold for 29 cents a gallon and oil was 15 cents a quart. Today gasoline costs upwards of $1.29, and oil exceeds a $1 a quart—increases of more than 300 percent and 500 percent.

And what can volunteers deduct for their mileage?

Only nine cents a mile, just a 28 percent increase in 25 years.

It is no surprise, then, that volunteer leaders report their frustration in trying to recruit and retain volunteers and their cars.

The Junior League of Denver reports a sharp drop in school volunteers, especially low income urban areas where mothers must drive crosstown to reach their childrens' schools.

The Director of the Colorado Office of Volunteerism reports that three seniors programs are threatened because the low mileage deduction allowed by the IRS makes it impossible for seniors to fit volunteer work and expense into their limited budgets.

The District of Columbia Retired Senior Volunteer program reports that "volunteers are unable to continue volunteering as a result of high costs of driving their car."

Contact, a youth community communications hotline in Syracuse, New York, reports increasing resistance from volunteers to requests for participation in workshops away from volunteers' homes.

Montgomery County, Maryland reports a dramatic decrease in willingness of volunteers to provide cars to deliver services. It is so serious the county is considering loaning county cars to volunteers, at considerable expense to the county.

These and other case histories underscore why this legislation is urgently needed. High gasoline costs and the refusal of the federal government to allow volunteers an adequate deduction for mileage costs in computing their federal income taxes jeopardize the quality—and in some cases, the very existence—of many vital volunteer programs.

Congress should not want responsibility for the decline in volunteerism.

To help the spirit of volunteerism to prosper, I urge quick enactment of the Good Samaritan Volunteer Mileage Bill.

STATEMENT OF MS. SANDRA CRAWFORD, DIRECTOR OF PUBLIC POLICY, THE ASSOCIATION OF JUNIOR LEAGUES INC., NEW YORK, N.Y.

Ms. **Crawford**. Thank you, Mr. Chairman. My name is Sandy Crawford. I am the past president of the Junior League of Philadelphia, and currently chairman of the Public Policy Committee and a member of the board of directors of the association of Junior Leagues, all volunteer positions. I appreciate this opportunity to appear before you today to express the association's strong support for S. 1579, sponsored by Senator Armstrong, and S. 1167, sponsored by Senator Durenberger, legislation which would recognize the contributions of volunteers by allowing volunteers to take the same mileage deductions as that allowed businessmen or the rate allowed Government employees as reimbursement when they use their own vehicles for Government business. We are here today to reaffirm our support of this legislation because it reflects the association's belief in the importance of volunteer work and acknowledges the rising costs incurred by volunteers in providing their services. I am also submitting for the record letters from two other major voluntary organizations—Independent Sector, and the United Way of America—in support of the association's statement.

[The two letters follow:]

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Adam Yarmolinsky

July 28, 1983

Ms. Deborah Seidel
Executive Director
Association of Junior Leagues, Inc.
825 Third Avenue
New York, NY 10022

Dear Deborah:

INDEPENDENT SECTOR, on behalf of its 500 members which include national voluntary associations, foundations, and business corporations, strongly endorses the testimony of the Association of Junior Leagues, Inc. on S 1167 (Durenberger, R-MN) and S 1579 (Armstrong, R-CO). The legislation is important because it permits volunteers who use their private automobiles for charitable activities, to receive the same tax deduction that businesspersons or government employees receive for use of their personal automobiles in business or government activities.

The need for this legislation is clear. Recent cuts in Federal funding have placed an enormous strain on nonprofit organizations to increase their services. The total reduction in federal dollars for human service programs over the five-year period FY82-86, will be $108 billion below 1980 levels, after adjusting for inflation. Of that amount, nonprofits stand to lose $27.8 billion, over the same time period. In the face of these massive cuts, many people are turning to nonprofit organizations for services which had formerly been funded by public dollars. However, voluntary groups are facing serious problems in recruiting volunteers to perform services which require those volunteers to use their private automobiles.

Several studies, one by Montgomery County, Maryland and the other by the National Center for Citizen Involvement, have documented the problem in recruiting volunteers to carry out activities where the volunteers are expected to use his/her private automobile. They have found that the $.09 per mile deduction permitted by current law to taxpayers who use their cars for volunteer work is wholly inadequate. This is best illustrated by information from the American Automobile Association which estimates that per mile driving costs are $.32 per mile for those who drive under 10,000 miles per year and $.24 per mile for motorists driving 15,000 miles per year.

A NATIONAL FORUM TO ENCOURAGE GIVING, VOLUNTEERING AND NOT • FOR • PROFIT INITIATIVE
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SUCCESSOR TO THE COALITION OF NATIONAL VOLUNTARY ORGANIZATIONS AND THE NATIONAL COUNCIL ON PHILANTHROPY

Ms. Deborah Seidel
July 28, 1983
Page Two--

Volunteers contribute time which is valued at $64.5 billion each year. More than 84 million Americans volunteer each year in this nation. In view of the recent cuts in Federal funding of human service programs, it is exceedingly important that everything possible be done to continue encouraging people to volunteer their services. We strongly urge that volunteers be permitted the same deduction for the use of their private automobiles in carrying out volunteer activities, as is permitted government employees and businesspersons.

Sincerely,

Brian O'Connell

Brian O'Connell
President

BO'C/lso

United Way
of America

United Way Plaza
Alexandria, Virginia 22314-2088
Phone 703-836-7100

July 28, 1983

Honorable Bob Packwood
Chairman, Subcommittee on Taxation and
Debt Management
Committee on Finance
United States Senate
SD221 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

United Way of America strongly supports the position of the Association of Junior Leagues regarding S 1579. Our Government Relations Committee and Board of Governors passed a resolution in February stating our continued support for legislation making the volunteer mileage deduction equal to that allowed for business. The importance of remedying this disparity was also raised by the member 1,200 United Ways around the country through our issue identification process.

As we have written to this committee before, "we believe the Department of Treasury is wrong to exclude proportionate shares of general upkeep from the charitable mileage allowance....Wear and tear on tires, engines and exhaust systems of cars are directly related to the miles traveled in the course of providing voluntary services and, therefore, should be included in the mileage allowance."

We urge the committee to report out this legislation favorably, both because it would spur on additional volunteering and because it is a public policy acknowledgement that volunteering is a highly valued service.

Sincerely,

Jack Moskowitz
Senior Vice President
Federal Government Relations

JM/pel

Ms. Crawford. I would like this morning to highlight our written testimony, but I request that the written testimony in its entirety be included in the record.

Senator Armstrong. Thank you. We would be very happy to do that.

Ms. Crawford. Thank you, Mr. Chairman.

[The prepared statement of Ms. Sandra Crawford follows:]

THE ASSOCIATION OF JUNIOR LEAGUES, INC.

TESTIMONY
OF
THE ASSOCIATION OF JUNIOR LEAGUES, INC.
BEFORE THE
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
OF THE
SENATE COMMITTEE ON FINANCE
IN SUPPORT OF S. 1579 AND S. 1167
ON
AUGUST 1, 1983
WITH ATTACHED LETTERS OF SUPPORT FROM
INDEPENDENT SECTOR
AND
UNITED WAY OF AMERICA

PRESENTED BY
SANDRA CRAWFORD
CHAIRMAN, PUBLIC POLICY COMMITTEE
THE ASSOCIATION OF JUNIOR LEAGUES, INC.

825 THIRD AVENUE, NEW YORK, N.Y. 10022 • (212) 355-4380

SUMMARY

The Association of Junior Leagues urges the Subcommittee on Taxation and Debt Management of the Senate Committee on Finance to support S. 1579 and S. 1167, legislation which would allow volunteers to take the same mileage deduction as businessmen or set the mileage deduction for volunteers at the rate allowed government employees as reimbursement when they use their vehicles for government business.

The Association's testimony is supported by the Independent Sector and the United Way of America.

I. The Association

   A. International women's voluntary organization

   B. 243 Junior Leagues; 148,000 individual members in the United States

   C. Promotes the solution of community problems through voluntary citizen involvement, and trains Junior League members to be effective voluntary participants in their communities

II. Volunteer Mileage Deduction Should Be Computed on the Same Basis as Reimbursement Granted Government Employees

   A. Volunteers such as Junior League members contribute many hours to a wide range of valuable community projects, often traveling long distances to their volunteer assignments. The low mileage deduction allowed to volunteers is especially detrimental to the elderly--many of whom wish to volunteer but are living on a fixed income which restricts their financial activities.

   B. The high costs of operating a car and the Internal Revenue Services' refusal to allow volunteers an adequate deduction for mileage costs have forced many volunteers to reduce their volunteer commitment, thus jeopardizing the existence of vital community projects.

   C. Denying volunteers the same mileage deduction as that granted businessmen or the mileage reimbursement rate allowed government employees indicates that government does not consider volunteers' services to be of equal value to those provided by paid employees.

   D. It is especially important at this time of federal funding cutbacks that government policies encourage, not discourage volunteer work.

I am Sandra Crawford, of Gladwyne, Pennsylvania, chairman of the Association of Junior League's Public Policy Committee and a past president of the Junior League of Philadelphia. I appreciate this opportunity to appear before you today to express the Association's strong support for S. 1579, sponsored by Senator William Armstrong (R-CO), and S. 1167, sponsored by Senator David Durenberger (R-MN), legislation which would recognize the contributions of volunteers by allowing volunteers to take the same mileage deduction as that allowed businessmen or setting the mileage deduction for volunteers at the rate allowed government employees as reimbursement when they use their vehicles for government business. We supported similar legislation in the last two sessions of Congress. We are here today to reaffirm our support of this legislation because it reflects the Association's belief in the importance of volunteer work and acknowledges the rising costs incurred by volunteers in providing their services. I also am submitting for the record letters from two other major voluntary organizations, Independent Sector and the United Way of America, in support of the Association's statement.

Junior League Volunteers

The Association of Junior Leagues is an international voluntary organization with 243 member Leagues in the United States, representing approximately 148,000 individual members. Junior Leagues promote the solution of community problems through voluntary citizen involvement and train their members to be effective voluntary participants in their communities. Every active Junior League member must make a commitment to a volunteer position. In addition, Junior Leagues develop projects and raise funds for community programs. During 1981-82, Junior Leagues sponsored 1,740 projects in their communities and netted more than $14 million from various benefits and ongoing money raisers such as thrift shops, cookbooks, auctions, and sponsorship of cultural and sporting events.

The money raised by these Junior League fundraisers is used to support projects in the community such as services to children and their families, adolescents, the aged and populations experiencing special problems, e.g., drug abusers, alcoholics and battered women, as well as programs concerned with the arts, urban conservation and the protection of the environment. These programs are made possible by Junior League volunteers who often drive long distances to their volunteer jobs.

In larger metropolitan areas, it is not uncommon for a Junior League member to make a 50-mile round trip to her volunteer assignment. However, Junior Leagues, like many other volunteer organizations, are finding that their members are increasingly reluctant to make firm commitments to regular volunteer placements which are many miles from their homes. High gasoline costs and the refusal of the Internal Revenue Service to allow volunteers an adequate deduction for mileage costs in computing their federal income taxes jeopardize the quality and, in some cases, the very existence of many vital programs. Faced with the high cost of driving, a volunteer may cut her involvement with a program from once or twice a week to once every two weeks or even once a month. This could harm programs such as Meals on Wheels or tutoring programs which require brief but frequent time commitments.

In fact, the difficulty in recruiting and keeping volunteers for the Meals on Wheels programs served as the catalyst for passage of Colorado's volunteer mileage deduction legislation. When the Junior League of Denver sought a sponsor for the legislation in 1981, it turned to State Representative Eunice Fine, a Republican from Greeley, Colorado, whose blind mother receives deliveries from Meals on Wheels. At that time, the Meals on Wheels program in Greeley was having difficulty recruiting volunteers because of the cost of driving and the low mileage deduction allowed volunteers. Representative Fine could not travel to Denver to attend sessions of the legislature unless her mother, who lives alone in Greeley, received her meals. Knowing firsthand the importance of the volunteer mileage deduction, Representative Fine agreed to sponsor the legislation. The decline in the number of drivers for Meals on Wheels also was a factor in the decision of the Volunteer Bureau of Des Moines, assisted by the Junior League of Des Moines, to launch its successful campaign for passage of state volunteer mileage deduction legislation in 1981. Junior Leagues in Arkansas, North Carolina and Maryland also supported the passage of volunteer mileage legislation in their states. The Junior League of Portland, Oregon, and the National Council of Jewish Women organized support for volunteer mileage deduction legislation in Oregon, but the bill was not reported out of committee.

Volunteers Should Receive Equal Consideration

The mileage deduction allowed volunteers is based on what the Internal Revenue Service considers out-of-pocket expenses, i.e., gasoline and oil.

The mileage deduction allowed businessmen and the reimbursement rate granted government employees, however, are based on the computation of the average costs of depreciation, maintenance, repairs, tires, gasoline and its related taxes, motor oil, insurance and registration fees. Currently, businessmen are allowed a deduction of 20 cents per mile, and government employees are allowed reimbursement at the rate of 20.5 cents per mile. Volunteers, however, are only allowed to deduct nine cents per mile.

We believe that the volunteer mileage deduction should be computed on the same basis as that used for computing the deduction allowed businessmen or the reimbursement rate granted government employees. However, the Department of the Treasury refuses to do this because it considers volunteers' automobiles primarily personal vehicles and refuses to allow consideration of a proportionate share of general maintenance, general repairs, depreciation or fixed costs, such as insurance or registration fees, in computing the volunteer mileage deduction. Yet, we want to emphasize that gasoline and oil costs alone are not the sole cost of driving...even for the volunteer who already has a car.

The federal government's refusal to allow volunteers the same mileage deduction as that granted businessmen not only is a failure to focus on the actual costs of operating a car such as wear and tear on the tires, engine and exhaust system; it also indicates that the government does not consider the services of volunteers to be of equal value to society as those provided by paid employees. Furthermore, we believe the government's refusal to grant volunteers the same mileage deduction as that allowed businessmen is totally inconsistent with the Administration's stated policy of encouraging voluntarism.

Some justify the IRS position by pointing out that government officials and businessmen pay taxes on the salaries they earn while using their cars. However, volunteers make an equally important contribution to society: they provide their time without pay to those persons and institutions most in need. Discouraging volunteer work with such policies as refusing to increase the volunteer mileage deduction will only lead to increased costs for the public sector if it is forced to assume services now provided by unpaid volunteers. It is especially important at this time of massive cutbacks in federal funding for social services, the arts and education that volunteers be encouraged, not discouraged, to provide their valuable services.

It is true that increasing the volunteer mileage deduction would take away some revenue from the federal budget. The Association's response to this argument is that the cost of the volunteer mileage deduction is far outweighed by the value of the contributed time. Last year, for instance, the members of the Junior League of Minneapolis contributed 203,000 volunteer hours. At the minimum wage, this contribution was worth $682,500--certainly a great deal more than the amount of tax revenues that would be lost because of the volunteer mileage deduction.

High Costs of Operating a Car

Although the price of gasoline has dropped in recent months, the rate set for the volunteer mileage deduction by the IRS is still lower than the estimates of operating costs provided by the American Automobile Association (AAA). The AAA estimates the operating costs to be 25.9 cents per mile for a six-cylinder standard car which is driven 15,000 or more miles per year. The cost per mile rises if the car is driven less--as many cars are. For example, the cost per mile for the same car would be 34.5 cents per mile if it is driven 10,000 miles a year.

Use of Automobile

We also question the government assumption that all cars used for business or government purposes are solely business vehicles. Persons with part-time jobs may have purchased their cars well before becoming employed, yet all their business driving is calculated at the higher mileage deduction rate allowed businessmen or the reimbursement rate allowed government employees.

Furthermore, the Internal Revenue Service's policy regarding the volunteer mileage deduction discriminates against the volunteer who is not employed outside the home--housewives or retired persons of both sexes. Elderly persons on fixed incomes are especially adversely affected by the nine cent volunteer mileage deduction. The director of the Colorado Office of Voluntarism, which operates under the aegis of the governor's office, reports that the activities most directly affected by the refusal of the IRS to raise the volunteer mileage deduction are the Senior Volunteer, Foster Grandparent and Senior Companion programs. Many of the participants in these programs are eager to volunteer, giving of their time to assist others provides them with a sense of accomplishment and a meaningful way of using their empty hours. However, the low mileage deduction often makes it impossible for them to accommodate volunteering into their limited budgets. We know, from the Association's experience with Volunteers Intervening for Equity (VIE), a national project that organized and trained older volunteers for community service, that retired persons make effective, caring volunteers. In turn, volunteering gives them a sense of accomplishment and being needed by their communities.

The experience in Colorado with the volunteer mileage deduction also highlights the need for the deduction among all volunteer groups. Colorado's legislation is restricted to those volunteering in health, nutrition or medical endeavors. These volunteers are allowed to deduct an additional 11 cents per mile from their Colorado state income tax. The Office of Volunteers in Colorado reports that the volunteer campground groups, which act as hosts at the state parks, are having difficulty in recruiting volunteers. Prospective volunteers for the campground programs hesitate to pledge their time because of the high cost of traveling long distances coupled with the fact that the state mileage deduction is not available to them.

The Junior League of Denver also cites an adverse effect on volunteers in education. There has been a drop in school volunteers, especially in low-income areas and in urban areas such as Denver where mothers must drive across town to reach their children's schools. Today's high cost of living makes it necessary for many parents of young children to live on very tight budgets which allow little room for the costs of volunteering. It is important to recognize that there are additional expenses unrelated to driving connected with volunteering, such as child care, meals and telephone calls. The cumulative effect of these costs serves as a disincentive to voluntarism. This could be partially modified by the legislation being considered here today.

Last year, when we appeared before this committee, we cited a question posed by the Junior League of Eugene, Oregon, at a meeting of Junior Leagues in the northwest. We think that statement is still relevant:

> Will...voluntarism become a luxury that many of our members can no longer afford? Even as we sit here today we are confronted with the fact that our hours of labor donated to our communities are not evaluated on the same plane as the hours of labor put in by the businessman or businesswoman. While we altruistically give of our time the businessperson's time yields monetary gains. Mileage incurred on our "job" may be deducted at 9 cents per mile while the businessperson deducts 20 cents per mile. Child care comes straight from the pocket of the volunteer with young children while the businesswoman takes a tax credit for child care expenses incurred during her work day...

The Association of Junior Leagues is committed to ensuring that voluntarism does not become a luxury for its members or any other member of our society. We believe our society would be gravely impaired by a loss of the sense of caring and serving that voluntarism encompasses. We urge this subcommittee to help the spirit of voluntarism flourish by recommending passage of legislation to make the volunteer mileage deduction equal to that granted a businessman or the reimbursement rate set for government employees who use their own cars on government business. We strongly believe that it is unfair for the federal government to place increasing demands on volunteers without providing recognition and support for their work. An adjustment in the volunteer mileage deduction is long overdue. We urge this subcommittee to take the leadership on this issue by reporting out the volunteer mileage legislation.

Thank you for this opportunity to appear before you today.

Sandra Crawford
Chairman, Public Policy Committee
The Association of Junior Leagues, Inc.

Ms. **Crawford**. The Association of Junior League is an international women's voluntary organization with 148,000 members and 243 leagues in the United States. Every active member of a Junior League must make a commitment to a volunteer position. In addition, Junior Leagues develop projects and raise funds for community programs. During 1981–82, Junior Leagues sponsored 1,740 projects in their communities and netted more than $14 million from various fund raisers. The monies raised by these Junior League fundraisers is used to support projects in the community, such as services to children and their families, the aged, drug abusers, and battered women, as well as programs concerned with the arts, conservation, and protection of the environment. These programs are made possible by Junior League volunteers who often drive long distances to their volunteer jobs. In fact, in large metropolitan areas, it is not uncommon for a Junior League member to make a round trip of 50 miles in order to get to her volunteer assignment. In my own league, which covers eight counties surrounding Philadelphia, some of our members travel in excess of 75 miles round trip. However, many Junior League members, including the Junior League of Philadelphia members, and other volunteers, are becoming reluctant to make firm commitments to regular volunteer placements which are many miles from their homes. High gasoline cost and the refusal of the Internal Revenue Service to allow volunteers an adequate deduction for mileage costs in computing their Federal income taxes jeopardizes the quality and, in some cases, the very existence of many vital programs. The volunteers' response to this high cost of driving may be the cut from once to twice weekly involvement to maybe only once every 2 weeks or even once a month. This could especially harm programs such as Meals on Wheels or tutoring programs which require brief but frequent time commitment.

In fact, the difficulty of recruiting and keeping volunteers for the Meals on Wheels program served as a catalyst for passage of Colorado's volunteer mileage deduction legislation. The Junior League of Denver turned to their State representative, Eunice Fine, a Republican from Greeley, Colo., who has a blind mother, who lives alone. This mother receives deliveries from Wheels on Meals. When Meals on Wheels had difficulty recruiting volunteers because of the cost of driving and the low mileage deduction allowed volunteers, the mother's deliveries were in jeopardy. Representative Fine could not travel to Denver to attend sessions of the legislature unless her mother received these meals. As a result, Representative Fine sponsored legislation for State volunteer mileage deduction.

Junior Leagues in Iowa, Arkansas, North Carolina, Maryland, and Oregon have also supported the passage of volunteer mileage deductions in their own States.

Volunteer mileage deductions are based on out-of-pocket expenses—gas and oil—while those for businessmen and Government workers are based on all the costs involved. Volunteer mileage deduction is only 9 cents a mile while that for businessmen is 20 cents and for Government workers, 20.5 cents. The Federal Government's refusal to allow volunteers the same mileage deduction as that granted businessmen not only is a failure to focus on the actual cost of operating a car, it also indicates that the Government does not consider the service of volunteers to be of equal value to society as those provided by paid employees.

The Association of Junior Leagues is committed to insuring that volunteerism does not become a luxury for its members or any of the other 84 million volunteers who give their time valued at $64.5 billion each year. We believe our society would be greatly impaired by a loss of the sense of caring and serving that volunteerism encompasses. We urge the subcommittee to help the spirit of volunteerism flourish, recommending passage of legislation to make a volunteer mileage deduction equal to that granted a businessman or the reimbursement rate set for Government employees. We strongly believe that it is unfair for the Federal Government to place increasing demands on volunteers without providing recognition and support for their work. We urge this subcommittee to take the leadership on this issue by reporting out the volunteer mileage legislation. Thank you very much for the opportunity to be here.

Senator ARMSTRONG. Well thank you very much. We appreciate your statement. Mr. Miller?

STATEMENT OF JOSEPH E. MILLER, JR., ASSISTANT DIRECTOR, NATIONAL LEGISLATIVE COMMISSION, THE AMERICAN LEGION

Mr. MILLER. I am Joseph E. Miller, Mr. Chairman, the assistant director of the National Legislative Commission of the American Legion. With your permission, I would like to summarize and paraphrase my comments, and have the entire statement included for the record.

Senator ARMSTRONG. Yes, we would like to put the entire statement in the record, and we are glad to have your additional comments.

[The prepared statement of Joseph E. Miller, Jr., follows:]

Statement of

The American Legion

1608 K STREET, N. W.
WASHINGTON, D. C. 20006

JOSEPH E. MILLER, JR., ASSISTANT DIRECTOR
NATIONAL LEGISLATIVE COMMISSION
THE AMERICAN LEGION

before the

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
COMMITTEE ON FINANCE
UNITED STATES SENATE

on

INCREASES IN VOLUNTEER MILEAGE TAX DEDUCTION

AUGUST 1, 1983

STATEMENT OF JOSEPH E. MILLER, JR., ASSISTANT DIRECTOR
NATIONAL LEGISLATIVE COMMISSION
THE AMERICAN LEGION
BEFORE THE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
COMMITTEE ON FINANCE
UNITED STATES SENATE
AUGUST 1, 1983

Mr. Chairman and Members of the Subcommittee on Taxation and Debt Management, The American Legion is pleased to appear before you today to present its views in support of S. 1167 and S. 1579, proposed legislation that would amend the Internal Revenue Code of 1954 to increase the volunteer mileage deduction to the same level enjoyed by persons engaged in using privately owned vehicles (POV) for business and government activities. The American Legion, perhaps the nation's largest volunteer organization, strongly encourages the enactment of the proposals of Senator Durenberger and Senator Armstrong to correct an inequity in the treatment of volunteers who use their POV's for volunteer related activities.

Since the birth of our organization on March 17, 1919, The American Legion has been actively involved in this country's volunteer efforts. In fact, one of the primary goals of our initial meeting was to create, "a fraternity dedicated to the equitable treatment of all veterans, particularly the disabled, their widows and orphans". Six months later, meeting in St. Louis, The American Legion finalized its preamble which concluded with the mission "to consecrate and sanctify our comradeship by our devotion to mutual helpfulness" (emphasis added).

Since those early days, The American Legion has expanded its volunteer activities to include athletic events (like Special Olympics), scholarship funds, blood donor programs and a multitude of community based volunteer activities too numerous to cite here. To illustrate our involvement, we would like to ask that several documents which explain Legion programs and activities be included for the record. In addition, we would like to submit for the record a copy of the 1982 Consolidated Posts Report indicating the degree of involvement of American Legion Posts in volunteer programs and activities at the community level. Today, there are 58 Departments and more than 16,000 American Legion Posts in this country and overseas. In addition, there are nearly 12,000 American Legion Auxiliary Units worldwide. Together, the Legion and its Auxiliary represent more than 3.6 million members who serve their communities and fellow Americans without pay. Our membership looks to the federal government to recognize their contributions and services and for equitable treatment. National Volunteer Week is but one way the government has recognized the achievement of volunteers. Many of our members also depend on the volunteer mileage tax deduction to defray a portion of the cost of providing their services to charitable activities.

The deduction volunteers take for miles driven is not compensation. Rather, it is to help offset the expense of operating an automibile which is being used to conduct volunteer activities. More importantly, however, it is the individuals who are helped by the Legion's, as well as other volunteer organization programs who are the real beneficiaries of the volunteer mileage tax deductions for without an adequate reimbursement, the programs aiding Americans in need might be greatly curtailed.

Presently, an inequity exists that threatens to deny beneficiaries those services that they desperately need. To illustrate the burden facing the volunteer driver today we would like to submit copies of two letters received by the Legion's Legislative Division. The inequity that we are referring to is between the allowable mileage rate tax deduction which can be taken by persons driving for business and the deduction which can be taken by those persons who use their automobiles to conduct charitable activities. Mr. Chairman, the correction of this inequity is long overdue. Given the state of the economy and the ever increasing reliance on volunteers to conduct programs once supported by federal revenues, the perpetuation of a dual reimbursement rate can no longer be supported by arguments of cost to Federal Treasury, enforceability or that the current mileage rate is adequate to cover the incremental costs directly attributable to the rendering of charitable services.

In April of 1982 this Subcommittee was presented with a table showing the anticipated revenue loss from a bill, S. 473, that like S. 1167, was introduced by Senator Durenberger. The Treasury estimated that the loss in federal revenues for FY 82 at $7 million; for FY 83 at $55 million; for FY 84 at $102 million; for FY 85 at $115 million; for FY 86 at $135 million and for FY 87 at $159 million. A total of $573 million in lost revenues from FY 82 through FY 87. Please notice that the anticipated loss from FY 82 to FY 83 increased by $48 million with a loss increase from FY 83 to FY

84 of $47 million. But, the loss increase from FY 84 to FY 85 is only $13 million and for the FY 86, $20 million and FY 87 the loss increase was projected at $24 million.

Clearly, something dramatic would have to be at work in order to account for these increases which gradually level out in Fiscal Years 84 through 87. There are several possiblities for the dramatic increases during the early fiscal years as shown by the Treasury's chart. First, there could be a substantial increase in the use of POV's for charitable purposes. Second, there could be a substantial increase in the use of POV's for charitable purposes and a corresponding increase in the number of individuals claiming the charitable mileage deduction. And third, the number of charitable miles driven annually might remain constant and thus the increased allowance will simply reflect the added cost per mile allowed as well as an increased number of people claiming the deduction. But, even the maximum anticipated revenue loss of $159 million during FY 87 would represent an investment of less than two one-hundredths of one percent of the total federal expenditures for that year, based on current out year projections.

Assuming that the third possibility is representative of what will actually occur, then we are left with the perplexing problem of explaining the mammoth increases projected by the Treasury for FY 83, a rate which is double the projected increases for each of the remaining out years. Since, even non-itemizers are now permitted to claim a deduction for charitable mileage, the increase can not be attributed solely to an increase in the number of people claiming exemptions, unless there is a corresponding increase in the number of miles driven on behalf of charitable activities. If there is a corresponding increase in the number of miles driven on behalf of charitable activities then S. 1167 and S. 1579 will have been successful in increasing the level of private sector volunteer participation which, in turn, will further decrease the demand for federal revenues. More importantly, however, is the added support to America's communities and citizens in need that the enactment of S. 1167 and S. 1579 will help to bring forth.

Another argument that has been advanced in opposition to the increase in the volunteer mileage deduction is that "of the difficulty in identifying and quantifying the amount of indirect costs in operating POV's for charitable purposes that are properly attributable to the charitable endeavors". The problem with this argument, as we see it, is that it assumes a difficulty that would not, in fact, be present since the volunteer mileage rate deduction would be tied to the business / federal employee mileage deduction rate. Further, the terms identification and quantification imply some sort of rule making requirement on the part of the Treasury that would be difficult to develop. Yet, no such regulations would be necessary. Indeed, S. 1167 and S. 1579 will simplify the regulatory burden of the Treasury Department because there will be one rate and one formula to determine that rate. Likewise, arguments regarding "enforceability" are groundless unless it can be shown that volunteers are somewhat less honest than persons taking business related deductions for private automobile use. We doubt that such is the case since a 1981 survey by the Gallup Organization indicates that approximately 84 million Americans, 52 percent of the adult population, typically donate some part of their time as volunteers.

Moreover, arguments which argue current law, as opposed to arguments which examine the merits of the proposed change, are not really arguments but rather statements in support of the maintenance of the status quo. But, the status quo is currently sending the wrong message to volunteers. The current mileage deduction differential between business/government and volunteers is telling the men and women who support community based volunteer programs that their services are not as valuable as the services of business and government employees. Yet, the Gallup study referred to earlier revealed that the estimated value of goods and services attributable to non-profit organizations during 1981 was nearly $64 billion. In 1980 another survey, by a different organization, estimated the value of non-profit services and products at $45 billion. The magnitude of this increase, $20 billion in one year brings the contribution of the non-profit community into proper focus. Volunteers and volunteer organizations have not been content with maintaining the status quo, indeed, they are actively seeking to increase their commitments to America's needy. But they need help.

Clearly, Mr. Chairman, non-profit organizations through the use of volunteers, including the Legion, have responded to the President's call for increased assistance to Americans in need from the private sector.

But, Mr. Chairman, lets look for a moment at the maintenance of the status quo. In 1957, the year prior to the institution of the volunteer mileage tax deduction, the average cost of a gallon of gasoline in the United States was $.309, and the allowable tax deduction was $.07 per mile. During 1983 the average cost of a gallon of gasoline has been $1.27 and the allowable tax deduction is $.09 per mile.

Looking at these figures in another way, we see that during the last 25 years the allowable deduction for charitable POV use has increased by 28.6 percent. While, during the same period, motor fuel has increased by 241 percent. Likewise, in 1957, the allowable deduction represented 22.7 percent of the cost of a gallon of gasoline but by 1983 the allowable deduction represented only 7 percent of the cost of a gallon of gasoline. For today's driver to maintain parity with the volunteer driver of 1958, in terms of percentage of cost, he would need an allowable deduction of $.28 a mile.

But, Mr. Chairman, the volunteer community is not asking that the volunteer mileage deduction be raised to $.28 a mile. Instead, the volunteer community is only asking for parity with persons who, today, use their automobiles for government and commercial purposes. We believe that this is not only a fair request, but a responsible request as well.

Mr. **Miller**. In addition, Mr. Chairman, I have two letters which were received by the Legion's legislative division last year regarding the volunteer mileage proposals, and which highlight concern of our people in the field. I would also like to introduce for the record a couple of documents which indicate the degree of involvement of the American Legion in volunteer programs and activities, and a copy of the 1982 consolidated post report, which details the level of that activity, with your permission.

Senator **Armstrong**. Yes. We would like to have that in the record also.

[The above two letters and the documents follows:]

5H00 4/16/82 April 13, 1982
Emerson, Ia

Dear Mr. Riggin,

I have been asked by Mrs Sylvia J. Klonis to write this letter to you.

I am President of the American Legion Auxiliary Unit 575 Emerson, Iowa and a volunteer.

This past year 1981, I put in 597¾ hr. of volunteer work. driveing 4,924 mi.
126 hr. at the Veterans Hospital, Omaha, Neb.
405 hr. at the Glenwood State Hospital School
61 hr. with the Iowa Special Olympics
and the remaining hr. serving as hostess at the Nishna Valley School, Hastings Ia. during National Education Week.

Our Legion Auxiliary is very small in numbers - 41 mem. 80% of these ladies Are in the 70-80 yr. Age range. So our money makeing projects are few. And funds very low. They offered me $5.00 a month to help on Gas to drive to the V.A. Hosp. in Omaha. As of the first of The yr. I have refused the money because it leaves no money for them to help in other ways - The money will now go to an Organization each mo. Such as Childs Welfare, fund, Reye's Syndrome + [illegible] at the Glenwood State Hosp. School

If President Reagan is serious about volunteers then he + Congress must help the volunteer in some way.

My husband is the Secondary Principal And Ath. Director At Nishna Valley Schools in Hastings, Iowa. At the present time our income alows me to do my volunteer work. But with the economy the way it is I may have to cut back. If I do it means 3 other volunteers will also cut back because they depend on me for transportation.

My sugestion is, at least a 20¢ tax break for Mileage and possibly a $5.00 break for each 100 hrs. of Volunteer work.

In your letter to Mrs Klonis you mention Mileage Bills, H.R. 768 and S. 473. Can I get more information about these bills.

Sincerely Mrs Donald R. Lee
Box 214
Emerson, Ia. 51533

Charlotte A. Lee
Box 214
Emerson, Iowa
51533

March 28, 1982

Rec. 3/31/82

Mr. Phil Riggin
1608 K St. N. W.
Washington, D. C. 2006

Important #28-F-21

Dear Phil:

Jim Bourie said you had requested that I should see if I could come up with some ideas of changes in the tax laws that might get more Volunteers.

The State of Ia. and Mills Co. in Ia. pays their help (like the Public Health Nurses) 22 cents a mile for using their own car, and the Government only allows 9 cents a mile for Volunteers. I think the Volunteers should be allowed the same amount for mileage as the paid employees. This to be in a tax credit and the Volunteer Hours verified. At the end of the year the Chief of Staff for the VAVS or the Activities Director at the State Schools could give the person a letter stating they had given so many hours and driven so many miles to do their Volunteer work.

Mrs. Charlotte Lee, Box 214, Emerson, Ia., 51533 drives 3 members of the American Legion Auxiliary from Malvern to the VAMC in Omaha, Ne. on the first Monday of the Month, which is approximately 102 miles (round trip), then each Tuesday she takes myself to the Glenwood State Hospital School, which makes her trip 40 miles round trip. Then she serves on a Human Resource Committee at the State School which meets once a week. To her the 22 cents a mile would mean quite a lot. A tax credit of 1500 dollars limit.

Harley Cooper, an employee at the State School suggested that a tax credit of $5 per 100 hours of Volunteer time be given to the Volunteers up to $100. This would be verified by the letter from the VAVS or State Schools.

If the Government would issue food stamps to persons over 55 (if they were Volunteering and meeting the other requirements for the program and needed them) with out registering with the Job Service. Especially, where there is no public transportation and you have to pay someone $10 per trip and go three times to be eligible for food stamps. for 6 months. You also have to go 16 different places to see about work and then drive approximately 80 to 90 miles round trip when there is a Job Service Office within 20 miles round trip. Then the Job Service spends money to verify the fact that you have been at that place looking for work, This is done by telephone.

As an example, my income is below proverty and with no transportation of my own and no public transportation to get someplace else to look for a job, but do have a ride to Volunteer work and I can't get food stamps.

Do you know what the deal is with the Government trying to take away the Veteran Organization's Non-Profit Status because of them having paid Lobbyist? And is there anyway, by writing the Legislators that I can help keep the Non-Profit Status.

Sorry, I haven't back to you sooner, but, thought I might get some more idea.

If there is anyway I can help let me know.

Sincerely,

Mrs. Sylvia J. Klonis
Box 37
MALVERN, IOWA
51551

American Legion PUFL 8264
1982 card Number IA.2-PUFL-0039
Post 520 Unit 520
American Legion Auxiliary Card No. B460452
Member of Ia. American Legion & Natl. Press Assocs.

AMERICAN LEGION POSTS - 1982 CONSOLIDATED REPORTS NATIONAL SUMMARY

General	1979-80	1980-81	1981-82
Membership current year (as of reporting date)	1,548,014	1,530,377	1,602,593
Membership past year (final)	1,556,020	1,541,064	1,626,653
New members initiated	40,478	40,806	37,960
Net assets	$526,197,915	$497,682,675	$629,775,063
IRS Form 990 filed	4,099	3,780	3,975
Post home owned debt free	3,482	3,354	3,589
Post home owned with debt	1,152	1,001	1,020
Post home rented	416	514	534
No cost for Post home	738	668	753
Other arrangement for Post home or meeting place	397	356	365
Rehabilitation			
Rehabilitation cases handled	355,101	286,395	471,766
Powers of attorney granted	87,097	50,211	63,832
Cash aid given veterans	$774,545	$685,245	$848,115
VAVS hours donated	904,996	888,640	1,018,754
Posts with Veterans Affairs and Rehabilitation Committee	1,354	1,359	1,462
Posts with Service Officer	5,322	5,325	5,667
Operation Post Home (new 80-81 category)	-	2,131	2,320
National Security			
Pints of blood given	113,207	105,692	112,509
Legion blood donors	62,672	58,755	59,918
ROTC medals given	3,972	3,585	3,891
Posts with crime resistance program	747	786	971
Posts working with Red Cross in disaster relief (new 81-82 category)	-	-	1,025
Public Relations			
Posts with Public Relations Chairman	3,480	3,539	3,812
Posts with regular paper or bulletin	2,806	2,776	2,910
Communications by cable television	364	358	444
Communications by radio	1,553	1,851	2,060
Communications by television	281	376	452
Communications by press (new 80-81 cat.)	-	3,585	4,035
Uniformed Groups			
Posts sponsoring color guard	3,400	3,505	3,779
Posts sponsoring firing squad	3,080	3,243	3,451
Posts sponsoring drum and bugle corps	178	174	180
Posts sponsoring band	161	149	156
Posts sponsoring drill team	300	337	364
Posts sponsoring other uniformed groups	0	229	269
Cost of uniformed groups	$1,380,911	$1,646,978	$1,505,759
Economic			
Posts with veterans employment program	1,160	1,138	1,142
Veterans assisted with finding jobs or training	28,422	33,785	26,874
Americanism			
Boys State			
Boys sponsored	16,034	15,615	16,979
Posts participating in Boys State	5,086	4,987	5,356
Cost of sending boys	$1,428,235	$1,510,459	$1,762,506
Baseball			
American Legion Baseball teams sponsored	2,012	2,037	2,127
Other athletic teams sponsored	2,236	2,295	2,321
Cost of all athletic teams	$4,711,042	$5,261,977	$5,984,372

BRIEF HISTORY OF THE AMERICAN LEGION

CHAPTER I

Foreword

WHATEVER ELSE war is—and it has been described in every way, from one slightly profane word to countless pages of histories and novels—it is a unique and memory-stirring experience for those who were most intimately involved as members of the armed forces. From the shared experiences and the quickened feeling of kinship have sprung many organizations of ex-servicemen.

While George Washington's army was still in the field, officers of the Continental Army formed the nation's first veterans' association—the Society of the Cincinnati.

Today there is no accurate record of the total number of veterans' organizations, but among them all, none has grown so large or has exercised such wide influence as has The American Legion. None is so intimately identified with the word "veteran." Since its origin in 1919 this largest of all veterans' organizations has become as integral and accepted a part of the American scene as hot dogs, baseball, and Presidential elections.

How did The American Legion achieve such a meteoric rise? With pictures and words, the following pages will trace the story of this giant of veterans' organizations from its conception on a foreign soil.

I. *Cradle Days*

THE AMERICAN LEGION was born at a caucus of the first American Expeditionary Force, March 15-17, 1919, in Paris, France. This caucus was the result of a proposal previously offered by Lt. Col. Theodore Roosevelt, Jr., to a group of representatives of A. E. F. divisions and service units. Roosevelt assisted in planning the Paris caucus, March 15-17, 1919, and called to order the subsequent caucus in the United States, May 8-10, 1919, in St. Louis, Missouri. His outstanding service during these vital periods of organization won for him the affectionate title "Father of The American Legion."

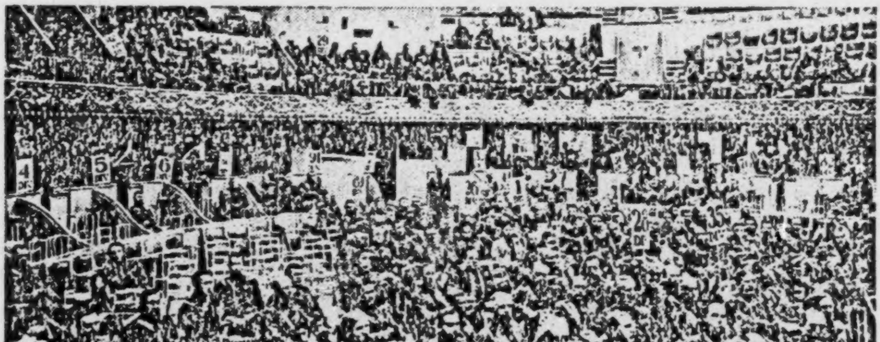
As the weary, homesick delegates assembled for the Paris caucus, they brought with them the raw materials with which to build an association of veterans whose primary devotion was to God and Country. In the minds of those men of the A. E. F. were a number of lofty ideals, uppermost among which were:

The title "Father of The American Legion" belongs to Theodore Roosevelt, Jr., who not only contributed a large portion of the initiative which resulted in the Paris Caucus but also served as temporary chairman of the St. Louis Caucus.

1. Creation of a fraternity based upon firm comradeship, born of war service, and dedicated to equitable treatment for all veterans, particularly the disabled, their widows, and their orphans;
2. National security for America, including a universal military training program for the prevention of future world conflicts;
3. Promotion of patriotism and the combating of materialistic and totalitarian ideologies which recognize neither the honor nor the dignity of the individual.

It was at this Paris caucus that The American Legion received its name. The distinction of naming the new organization went to Maurice K. Gordon, then a major in the 36th Division and later a judge in Kentucky. A controversy had developed concerning the name, and it was Gordon who made the successful motion to label the infant group The American Legion.

While lofty principles had been expounded at the Paris caucus, it was decided to leave the definition of permanent policies for a later and more representative meeting to be held in the United States. An executive com-



The American Legion was born March 15-17, 1919, at this caucus of the First American Expeditionary Force in Paris, France.

mittee of 100 members was named to complete the organization in the A. E. F. while a sub-committee of 17 returned to the United States to promote interest among those who had already returned to the States.

Even though The American Legion was formed overseas, it was realized that members of the armed services have no choice as to where they serve—in the United States or overseas. Accordingly, it was decided that membership in The American Legion should be open to all veterans who had served honorably in the armed forces in World War I. (Eligibility requirements for membership have since been revised to permit veterans who served honorably in the armed forces of the United States in World War II, Korean War and the Vietnam era to join The American Legion.)

St. Louis Caucus

"A representative democracy in a federal republic" was the plan adopted by the Paris caucus for the formation of The American Legion. Advance committees of two members from each state met May 6, 1919, in St. Louis, Missouri, to prepare for a general caucus May 8-10, 1919, there. This St. Louis caucus, attended by some 1,100 delegates, produced the blueprint of The American Legion, approved the principles set forth at the Paris caucus, adopted a tentative constitution, and created the machinery to provide for a permanent organization.

It was at the St. Louis caucus that the now famous Preamble to the Constitution of The American Legion was put into final form. A short preamble had been written at Paris by a sub-committee consisting of Frank White, William H. Curtiss, and Redmond C. Stewart. In St. Louis the now immortal Preamble was conceived by the fertile minds of John C. Greenway of Arizona, Hamilton Fish of New York, and George N. Davis of Delaware.

Organization work proceeded rapidly after the St. Louis caucus. Temporary offices were opened in New York City. On September 16, 1919, the Congress of the United States chartered The American Legion, thus giving official sanction to the Constitution adopted in St. Louis.

The charter convention of The American Legion met November 10-12, 1919, in Minneapolis, Minnesota. The rapid pace with which The American Legion was building its organization was evident by the presence of many delegates still in the uniforms of the armed forces. The Minneapolis convention of 1919 approved the acts of the temporary organization and adopted a permanent structure. The first American Legion National Convention parade—which was to set the pace for what has become the utmost in pageantry, color and martial music—was on the first anniversary of Armistice Day, November 11, 1919. Included in the line of march were the 648 delegates representing the infant organization's membership of 648,000.

A somber note was injected at this first convention with the arrival of news that four Legionnaires of a newly formed post at Centralia, Washington, while marching in the Armistice Day parade in their home city, were shot down in cold blood by members of the Industrial Workers of the World, a radical group incited by propaganda based on class hatred. Thus did The American Legion receive its first challenge by un-American elements, some of which to this day classify the Legion as their greatest enemy.

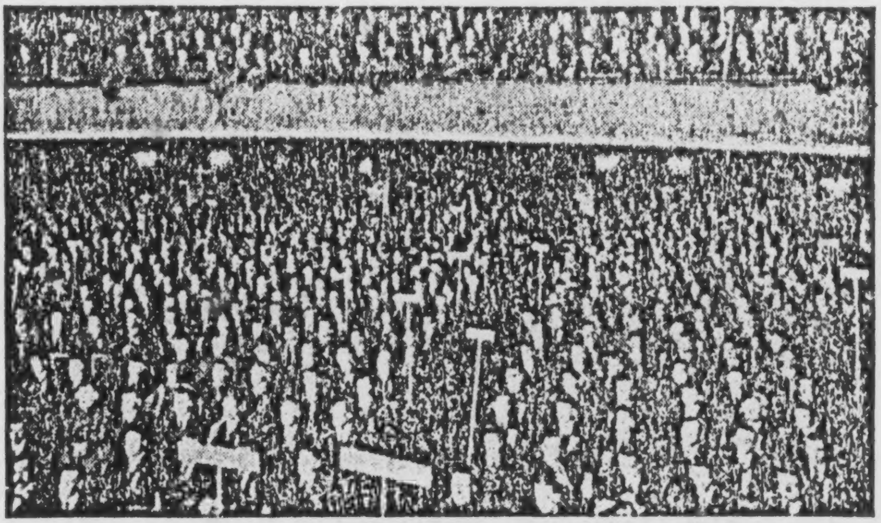
Franklin D'Olier of Pennsylvania became the first National Commander, and Lemuel Bolles of Washington, the first National Adjutant. D'Olier later became president of the Prudential Insurance Company, and performed several non-salaried tasks for his country during World War II.

Representatives of five cities—Detroit, Indianapolis, Kansas City, Minneapolis, and Washington, D. C.—vied to gain the new organization's permanent national headquarters. Indianapolis won, and the national headquarters of The American Legion were moved in late 1919 from their temporary location in New York City to the Hoosier capital.

II. *Veterans Affairs and Rehabilitation*

THE FOUNDERS OF The American Legion, when they met at the St. Louis caucus, recognized that a major concern of the organization would be the plight of the disabled veteran. The extent of the concern for these men is evident in the final phrase of the Preamble, "to consecrate and sanctify our comradeship by our devotion to mutual helpfulness."

The D'Olier administration completed organization of the National Service Bureau, which worked with state service bureaus and service officers of individual posts to assist veterans with problems of war risk insurance,



The organization of The American Legion was completed May 8-10, 1919, at this Continental Caucus in St. Louis, Missouri. Three delegates drafted the Constitution and By-Laws, and here the Preamble was written.

compensation for disabilities, hospital treatment, and vocational training. The American Legion received financial assistance in this phase of the program from the American Red Cross.

Immediately after the close of the 1920 convention in Cleveland, Ohio, National Commander Frederick W. Galbraith, Jr., called a conference in Washington, D. C., to consider the plight of disabled veterans resulting from an unwieldy mass of laws and regulations administered by several different government bureaus. Out of that conference came The American Legion's request for a Presidential committee to investigate existing conditions. As a result, the Dawes Committee, which included representatives of The American Legion, was appointed. The Dawes Committee report, accompanied by White House recommendations, brought about Congressional action consolidating most of the activities dealing with World War I veterans into a new independent agency—The United States Veterans Bureau (now the Veterans Administration).

The Veterans Bureau continued under careful study by The American Legion during the next two years, and many reforms were suggested by Legion leadership and put into effect, eliminating abuses that deprived veterans of hospital treatment and other rights authorized by Congress. It was in the same period that The American Legion improved its own procedures of handling veterans' matters by organizing the National Rehabilitation Committee to promote better administration of this important and highly complex activity. The National Rehabilitation Committee later became the National Rehabilitation Commission and, as the result of action taken by the 1970 National Convention, it was renamed the National Veterans Affairs and Rehabilitation Commission.

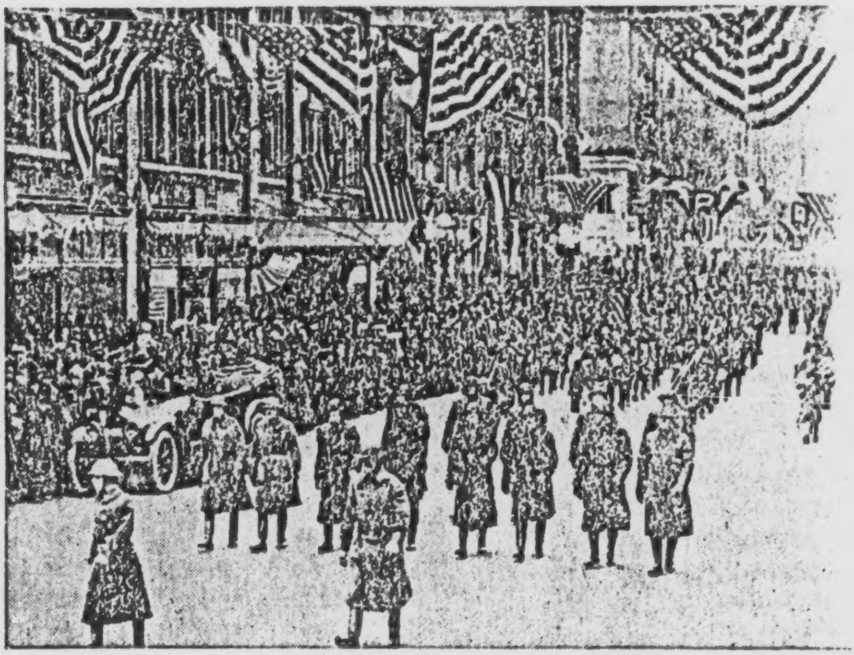
Justice for the disabled veteran was now The American Legion's fight in earnest. In 1923 the San Francisco Convention drafted 91 constructive recommendations for liberalization of laws and regulations governing veterans' benefits. Before the next National Convention was to gather, Congress had enacted the World War Veterans Act of 1924, which included many of The American Legion's proposals and extended the presumption of service connection for certain classes of disability.

Throughout the remainder of the 1920's and early into the 1930's, The American Legion continued to register legislative achievements necessary for the care and rehabilitation of disabled veterans.

Veterans Administration Established

On July 21, 1930, the Veterans Bureau and other agencies administering veterans' benefits were consolidated in the Veterans Administration, a new independent agency which thereafter handled most veteran benefit programs.

The American Legion's cause in behalf of disabled veterans' benefits faced one of its greatest challenges during the depression of the early 1930's. In



Delegates to the First National Convention, November 10-12, 1919, at Minneapo Minnesota, paraded in a snowstorm on the first anniversary of the Armistice, Novem 11.

1933 the new national administration passed what has since been kno as the infamous Economy Act, which wiped out a wide range of progra and benefits which had been won for disabled veterans by patient eff since the end of World War I.

However, The American Legion rallied to the crisis in veterans' affai The National Rehabilitation Committee at the convention in Chicago t same year put forth the famous Four-Point Program. This was, briefly, tha

1. No veteran disabled in line of duty suffer any reductions in benef granted under legislation in effect prior to March 19, 1933;
2. Federal hospitalization be afforded veterans not dishonorably di charged, requiring such care, and unable to pay reasonably for trea ment;
3. Participation of service connection for all veterans properly grante such service connection under law in existence prior to March 2 1933, be continued;
4. Benefits provided for dependents in the World War Veterans Act b restored and the thought established that in no event should widow and orphans of deceased World War veterans be without governmen protection.

The American Legion's unceasing fight in behalf of disabled veterans was rewarded March 28, 1934, when Congress enacted Public Law 141, carrying out in full the recommendations of the first three provisions of the Four-Point Program. Although this bill met with a Presidential veto, Congress overrode the veto. Thus, The American Legion recorded an outstanding accomplishment in the restoration of the major part of the benefits taken from disabled World War veterans by the Economy Act.

From this significant milestone, The American Legion has worked successfully for the passage of further legislation, liberalizing benefits for disabled veterans and bringing about the fourth provision of the Four-Point Program concerning protection of widows and orphans.

Since that major victory in 1934, the Legion has repeatedly mustered its resources to meet effectively subsequent challenges to reduce the role of the Veterans Administration in its essential mission of providing for our sick and disabled veterans. The increasing demand for VA hospital and medical services resulting from the returning wounded and disabled from Vietnam not only justified the Legion's earlier position in this matter but also strengthened its intensified endeavors for adequate Congressional appropriations to meet some of the needs of the newest generation of disabled war veterans.

III. *Children and Youth*

CLOSELY ALLIED with its concern for the disabled veteran is The American Legion's interest in the welfare of the children of deceased and disabled veterans. There is no definite time nor place which can be described as the beginning of The American Legion's Children and Youth Program (formerly known as Child Welfare Program). Like many of the purposes and principles set forth in the Preamble, the child welfare concepts undoubtedly were first formed on the battlefields of France during World War I, where shared dangers and hardships created a deep sense of responsibility for the children of fallen comrades.

The American Legion has two child welfare objectives: first, to assure care and protection for the children of veterans; second, to improve conditions for *all* children. These objectives are expressed in slogan form as "A Square Deal for Every Child."

First activities in the field of child welfare by The American Legion were carried on by Legion rehabilitation workers, who saw as early as 1922 that there was a need for special effort on behalf of these unfortunate youngsters.

In the mid-20's American Legion child welfare efforts were centered about the establishment of Legion-operated institutions known as "billets," where children of deceased and disabled veterans were housed and cared for. However, the experience of only a few years proved the institutional approach inadequate and unsatisfactory. A new concept of child care gradually emerged, placing central emphasis on the maintenance of the family home.

In 1925 a National Child Welfare Division was established in National Headquarters at Indianapolis. Within three years, the national organization had completely withdrawn from the institutional field and, in its place, was furthering a program of direct temporary assistance to needy children in their own homes.

This forward step by The American Legion, which was considered a new concept in child care, gave great impetus to the development of programs by many other organizations, both public and private, for the home care of children.

In order to finance its child welfare and rehabilitation programs, at least in part, The American Legion in 1924 launched a campaign to raise a $5,000,000.00 endowment fund. This goal was reached in little more than a year. In 1945 the endowment fund was increased to $7,000,000.00. In addition, the national budget for children and youth received generous contributions annually from the Legion's affiliated organizations—the American Legion Auxiliary and the Eight and Forty, and, up to 1959, from the Forty and Eight.

Emphasis Shifted to Concern for All Children

After World War II, the National Child Welfare Commission recognized the need to place added emphasis on sound public programs for all children in order to fulfill the purpose of guaranteeing care and protection to children of veterans. Because of the greatly increased segment of the nation's population which now was classified as "veteran" it was evident that the majority of all children in the United States would be of veteran parentage.

The change in emphasis to encourage and support good public programs for all children was the major factor in permitting The American Legion to fulfill its purposes in this area.

The National Child Welfare Commission recognized that many of the larger problems of child welfare cannot be met on the basis of direct help

One of the major areas of interest within The American Legion's Children and Youth Program is the education of the handicapped child, particularly the child who is multiply handicapped. Posts, districts, and departments are encouraged to participate jointly in programs with other organizations to meet the needs of these children.

to individual children. For example, immediately after World War II, a major cause of death among school age children was rheumatic fever and rheumatic heart disease. As a result of the joint interest of the National Child Welfare and Rehabilitation Commissions, the National Executive Committee in 1946 appropriated $25,000.00 to the American Heart Association to begin research on this problem. The American Legion Auxiliary appropriated a like amount, and the $50,000.00 so provided, in a large measure, launched the present program of the American Heart Association. As a result of this organization's research in medical science, we now know that rheumatic heart disease is an outgrowth of rheumatic fever and that rheumatic fever can actually be prevented. The research which was financed by this grant has been an important contribution to the decline in the rheumatic fever death rate among children.

Similarly, in 1950 The American Legion contributed $25,000.00 to the National Association for Mental Health, and the progress which has been made by research financed by this organization indicates that substantial results are being achieved in this critical area.

In order to avoid possible public misunderstanding of the purpose and scope of its child welfare program, The American Legion, by action of its 1970 National Convention, amended its Constitution and By-Laws in order to redesignate the National Child Welfare Commission as the National Commission on Children and Youth. This change did not affect the composition, purpose, or functions of the Commission and its program.

The American Legion Child Welfare Foundation, Inc.

By 1954 the wisdom of the grants to the American Heart Association and the National Association for Mental Health was quite apparent, and the need was felt for a recognized method by which future grants could be made which would bring the best results to the greatest number of children. In that year The American Legion Child Welfare Foundation, Inc., was authorized by the National Executive Committee with these two primary purposes:

1. To add to the sum total of man's knowledge about children and youth through research, study, etc.;
2. To help distribute information society already possesses about children in order that such information may be more adequately used.

This Foundation in no way supplants or supersedes The American Legion's traditional and continuing program for children and youth. Through its stimulation of preventive research, the acquisition and wide application of new knowledge and similar long-range efforts, the Foundation will supplement and make even more effective The American Legion's long standing program of direct assistance, legislation pertaining to children and youth, and general public information to further the streamlining of child care concepts. The Foundation is supported primarily through the generous contributions of individuals, posts, units, departments, and the national organization of the American Legion Auxiliary. Currently memorial contributions for departed comrades made by individuals, posts, and units provide a part of its income.

But even more important than its income are the grants which the Foundation has made and the results which have been achieved. The Foundation is authorized to use such funds as are put at its disposal for the benefit of children and youth, with emphasis on research, special projects, and demonstrations. It has already made grants in the fields of juvenile delinquency, retarded children, mental health, institutional care, education, physical medicine, and specific areas of need, such as the study of alarmingly increased rates of venereal disease among teenagers, and increased emphasis on understanding and training children who are partially sighted.

The Foundation, though still small, has had tremendous national impact and the results of its work are already beginning to be felt. The Foundation is actually private enterprise in philanthropy, and just as our private enterprise system has proved so highly productive in the field of business and industry so also is private enterprise becoming equally fruitful in the broad field.

IV. *Americanism*

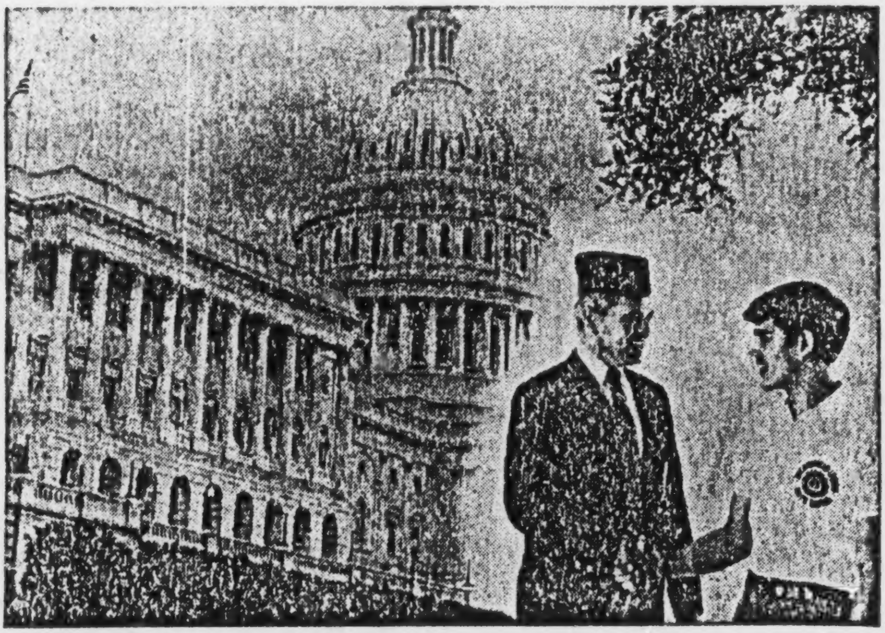
FROM ITS VERY beginning The American Legion was not content to confine its interest and support to easing the plight of the deceased and disabled veterans and their dependents. It also took as one of its major projects the preservation and furtherance of basic American concepts and principles. The St. Louis caucus in May 1919, considered as "its major concern—relief work, employment, and Americanism." At the charter convention that same year in Minneapolis, the National Americanism Commission was established. Its first assigned responsibilities included the combating of anti-Americanism tendencies, the education of citizens old and new in the ideals of true Americanism, the distribution of information about "the real nature and principles of American government," and the fostering of the teaching of Americanism in all schools.

It is the objective of the National Americanism Commission to translate Americanism precepts, principles, and ideals in an understandable manner to posts and to other groups and individuals.

This mission has led the National Americanism Commission over a sometimes difficult route. Early in the 1920's, unemployment and a period of general national unrest coincided with an upsurge of communism and other subversive theories. The Americanism Commission has met these challenges through the years with education and action.

Much of the Commission's work was concerned with the problems of unemployment until that particular phase was assigned as a responsibility of the National Economic Commission.

In order "to foster and perpetuate a 100 percent Americanism," a large segment of the Americanism Commission's total effort is channeled into education programs and citizenship activities for our youth—the leaders of tomorrow. Millions of America's youth have gained a better understanding of the Constitution of the United States through The American Legion's National High School Oratorical Contest, in which several thousand students participate annually.



The annual session of American Legion Boys Nation draws the two most outstanding young men from each of the department-sponsored Boys States to Washington, D.C., for a first-hand look at the workings of the federal government.

Boys State and Boys Nation

For more than a quarter century, American Legion Boys States have given an inside look at the demands of good citizenship and civic responsibilities to about 30,000 of tomorrow's citizens attending these annual summer workshops in governmental operations. Boys Nation, which has functioned annually since 1946 in Washington, D. C., brings the most outstanding of these young American leaders to the nation's capital for even greater insight into the workings of the federal government.

Each year hundreds of thousands of American boys improve their physical fitness and develop a keener sense of good sportsmanship, good citizenship, and fair play through American Legion Baseball, which has been in existence since 1926. This program, which enjoys financial support and valuable assistance from organized baseball, has also proved to be a fruitful proving ground for some of the finest talent in the history of this great American game.

As a part of its Americanism program, The American Legion encourages the recognition of students who display the highest qualities of citizenship. American Legion School Medal Awards are presented annually to about 27,000 boys and girls in elementary, junior, or senior high schools who are outstanding in honor, courage, scholarship, leadership, and service.

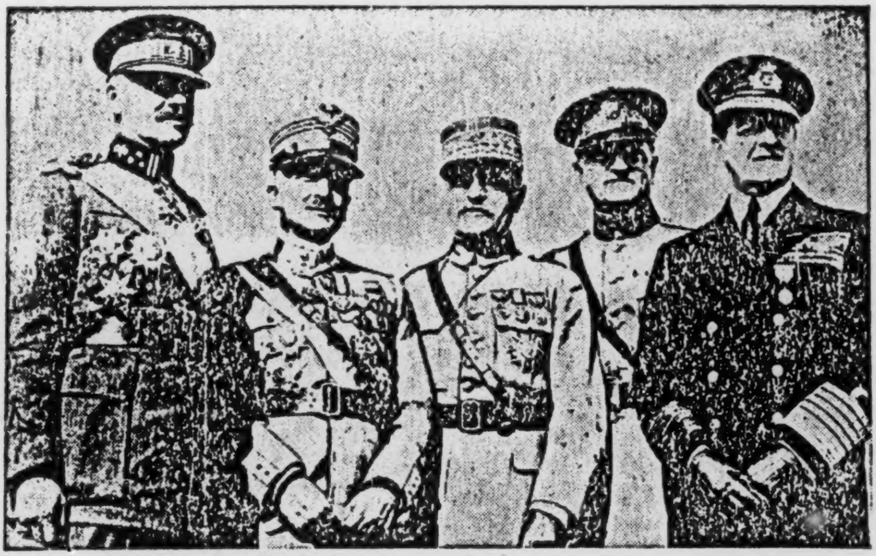
In support of the outstanding citizenship training, character building, and physical development programs set forth by the Boy Scouts of America, American Legion Posts throughout the Nation sponsor about 2,700 Scout units—Cub Packs, Scout Troops, and Explorer Units.

American Education Week was founded in 1921 by The American Legion. From the beginning, the aim of this promotion has been the improvement of citizenship. The Legion has since been joined by the National Education Association, the United States Office of Education, and the National Congress of Parents and Teachers in sponsorship of this program.

By action of the National Executive Committee at its May 1961 meeting the education and scholarship program which had been under the supervision of the National Child Welfare Commission was transferred to the National Americanism Commission. In 1951 this program published a career and scholarship handbook, "Need A Lift?", which has been revised and expanded annually to become recognized today as one of the most complete sources of this information available in the United States. This handbook is distributed each year to American Legion posts and units that they may offer its information as assistance to the interested students and their parents in the community.

Our present Flag Code is the result of a cooperative effort in which The American Legion played a leading role in encouraging proper respect for an etiquette in display of the national colors. Great quantities of literature are mailed from the National Americanism and Children and Youth Division each year to stimulate patriotism and recognition of patriotic holidays. The sole purpose of this material is to assist Americans to be good citizens and to instill in their youngsters an enduring enthusiasm toward the American way of life.

In the field of anti-subversive activities The American Legion has gained nationwide recognition as the outstanding opponent of communism and other anti-American dogma. To combat the dangers presented to the perpetuation of the American way of life by these doctrines, the counter-subversive section of the Americanism Commission has gathered data which has been filed and catalogued in order that any Legionnaire through his



Allied leaders of World War I, as guests of The American Legion, meet again on the platform of the Third National Convention October 31-November 2, 1921, in Kansas City, Missouri. Left to right: Lieutenant General Jacques of Belgium, General Diaz of Italy, Marshal Foch of France, General of the Armies John J. Pershing, and Lord Beatty of Great Britain.

post and department may have at his command one of the best library and information services on subversives and subversive activities available anywhere. The dedicated efforts of this program are also implemented through the publication of a monthly news letter, *"FIRING LINE,"* a timely summary of information on domestic subversive activities.

V. *National Security*

THE DEEP-ROOTED interest of The American Legion in the security of the nation was born in the hearts and minds of its founders and those who piloted it through the treacherous waters of its early years. The bitter experiences of seeing comrades wounded and killed through lack of proper training crystallized the determination of these veterans to fight for an adequate defense establishment capable of protecting the sovereignty of the United States.

The tragic events of World War I, largely precipitated by unpreparedness, were still vivid in the minds of all combat veterans when the committee on military policy met at the 1919 National Convention in Minneapolis. The charter convention approved ten committee resolutions which embodied these important principles: Universal Military Training, retention of a small Regular establishment and creation of a citizens' army composed of an Organized Reserve and National Guard units.

In the intervening years, this original committee has grown to become the National Security Commission and Committees, which focus Legion attention to all segments of the nation's defense. In years since the birth of The American Legion, the United States has engaged in another World War and fought in Korea and Vietnam to oppose further aggression by the Communists. Perhaps these wars would not have occurred had our nation followed the pattern of American Legion recommendations on National Security matters.

During the 22 years separating the birth of The American Legion and the attack on Pearl Harbor, which brought the United States into World War II, The American Legion had been a consistent, though too often unheeded, voice advocating adequate military strength.

National Defense Act of 1920

The efforts of The American Legion, acting through its National Security Commission and Committees, resulted in the enactment of the National Defense Act of 1920, which gave the nation its first workable plan for a small Regular Army, augmented by a large National Guard and Organized Reserve. However, because appropriations for carrying out the provision of this act were repeatedly denied, the military establishment—which at the end of World War I had been as well prepared as that of any country in the world—was steadily reduced.

In the face of discouraging setbacks, The American Legion continued to propose recommendations which have had a profound effect on our nation's history. Twenty years prior to Pearl Harbor, The American Legion was calling for the equivalent of a two-ocean navy and firmly supported the development and utilization of a new weapon system, the airplane.

Throughout those 20 years prior to our entry in World War II, The American Legion remained unrelenting in its struggle for a strengthened national defense. In 1938 The American Legion demanded an air force of 8,000 planes and a production of 1,500 planes annually; a strengthening of our Pacific defenses, and the discontinuance of shipment of war supplies to Japan. Had it not been for The American Legion's efforts to alert America to the need for continuing preparedness, our nation at the time of Pearl Harbor would have been notably weaker than it was.

After the surrender of Germany and Japan in 1945, The American Legion again faced the unpleasant task of calling for a retention of adequate military strength in the face of an overwhelmingly popular demand for demobilization. Despite American Legion opposition, the American people permitted the greatest defense machinery in history to disintegrate and in so doing, encouraged communist aggression throughout the world.

Just as it had after World War I, The American Legion after World War II urged the Congress to enact Universal Military Training legislation, but it took the commitment of American manhood to fight again on foreign soil, this time in Korea, to convince the nation's lawmakers of the vital need of a Universal Military Training program. However, the legislation which embodied the principles of universal military training, which was passed by the 82nd Congress, contained several flaws which remained uncorrected until the enactment of the National Security Training Law, which was passed in July, 1955.

Today, with the evolution of space technology and scientific advancement of both conventional and nuclear weapons, The American Legion is again proving itself a pioneer by its insistent support of an adequate arsenal and a properly trained fighting force personnel as prime deterrents to aggressors.

VI. *Foreign Relations*

OF INTEREST TO ALL American veterans has been the subject of foreign affairs. This is as true today as it was with our nation's first veterans who, after the Revolutionary War, became leaders in the new republic. With each war the veterans became more intense in their desire to seek peace and national security. Such was the case with The American Legion following World War I. Not only did the veterans of this War have a keen desire to sustain peace, but they also had a solemn wish to perpetuate the battlefields and cemeteries overseas as living shrines to sacrifice and achievement. Thus, from its earliest convention, The American Legion expressed concern and interest in foreign affairs directed to these principles. Neither conservative nor liberal, neither international in character nor isolationist in principle, this foreign policy has been consistent in two respects: First, by continuing to protect American sovereignty and right; and secondly, by seeking world peace on the premise that the diplomatic front is often the first theater of operations which, if lost, inevitably leads to armed conflict.

In the period after World War I, while the infant veterans' organization was struggling for its very survival, its foreign relations policy was not as complex in character as it is today. Primarily, this policy was directed toward major items of concern to Legionnaires in the over-all interest of America, with special emphasis directed toward sustaining international peace. During the World War II period, the interest of The American Legion was essentially concerned with bringing the war to a successful conclusion and the securing of a world peace. Discussions during that period showed an interest on the part of many to create an international organization similar to that which is known today as the United Nations. Because the League of Nations, after World War I, had become a partisan, political issue in the United States, the young American Legion had neither endorsed nor repudiated this international organization.

Legion Supports United Nations

In 1945, then National Commander Edward Scheiberling was an observer at the conference in San Francisco where the United Nations organization took substantial form. At its National Convention that year in Chicago, The American Legion voted its full approval of the United Nations. At its next five National Conventions, The American Legion, recognizing weaknesses within the structure of the United Nations, advocated strengthening of the U. N. charter. The American Legion issued early and prophetic warnings that "the persistent misuse of the veto power by Soviet Russia is destroying the ability of the United Nations to prevent war," and that Russia "sought to sabotage the United Nations and thus weaken it for world peace and justice."

Thus it can be seen that at the conclusion of World War II and with the establishment of the United Nations, The American Legion's foreign relations policy bcame more intricate and complex. The veteran of World War II returned to civilian status far more internationally minded than his predecessor of World War I. He had served in the Pacific areas, in Europe, and in other regions of the world. He not only was keenly mindful of the extreme need for sustaining peace, but also he was intimately familiar with the many countries with which America must work in the future to maintain peace.

The Korean War eventually brought to the ranks of The American Legion a new veteran who, for the first time in American history, had fought as a member of an international force. Also, he was recognized as the first American veteran to meet in combat the ruthless communist forces which now seek to destroy the peace of the world. As a veteran and as a Legionnaire the man who had faced communism's fire has offered one more serious phase in the formation of The American Legion's foreign policy in recent years.

Foreign Policy Always Realistic

Thus, The American Legion's foreign policy, blueprinted at the St. Louis Caucus, endorsed and broadened at the first National Convention in Minneapolis, and adjusted to world conditions through the ensuing years, has always reflected realistic recommendations in the interest of promoting the security of America and peace and good will on earth.

Emanating from every community throughout the nation and representing all classes and religions in America, the foreign policy of The American Legion is a true reflection of the hopes and fears, the very desires and wants, of all America. In it are found the sentiments of the nation and through it a better American foreign policy can develop to insure the peace and freedom of the world.

VII. *Legislative*

As THE AMERICAN LEGION began to take form in the spring and summer of 1919, its leaders soon saw the need for a central legislative agency which could present the Legion's legislative programs effectively to the Congress. Such an agency who also needed to avoid departmental competition for legislation, without regard to priority established by need or American Legion national policy.

Therefore, one of the first committees created was the National Legislative Committee (now Commission) which was established prior to the first National Convention at Minneapolis.

The early responsibilities of the National Legislative Committee are described adequately by Marquis James in his History of The American Legion: ". . . . an essential cog in the national machinery to make veterans' voices heard and heeded in the council chambers of the nation where the laws are made, in the executive offices where they are enforced, and in the hundreds of department bureaus, great and small, from which the actual administration is directed." With the development of other national commissions, the implementation and policing of veteran's laws were taken over by them.

The initial action of the newly formed committee was to request Congressional recognition of The American Legion. The 66th Congress gave its stamp of approval to "An Act to Incorporate The American Legion" which became Public Law 47 with the President's signature on September 16, 1919. The charter limited membership to honorably discharged veterans with service between April 6, 1917, and November 11, 1918. Subsequent amendments have been made which established eligibility dates for membership of veterans of World War II, December 7, 1941, to December 31, 1946; the Korean War, June 25, 1950, to January 31, 1955; and the Vietnam era, August 5, 1964, to May 7, 1975.*

The National Legislative Commission is not authorized to formulate policy; it is a staff agency only, charged with the exclusive responsibility of petitioning Congress in behalf of any and all legislation in which The American Legion is interested. Declaration of legislative policy is the right and responsibility of national conventions. Between conventions the National Executive Committee may mandate legislative action.

Legislative Commission Serves Entire Organization

Since it has no program of its own, the National Legislative Commission serves the entire American Legion, and the results of its work since 1919 are interwoven with the several American Legion programs. In the various states, department legislative committees operate on much the same basis, and their efforts have resulted in many legislative successes in such areas as rehabilitation, aid to war veterans, and child welfare.

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* Congressional action pending to amend Section 5 of the Charter of The American Legion. If adopted, the dates for the Vietnam era will be December 22, 1961 to May 7, 1975.

In 1919 war veterans returned to a national community which was almost totally unprepared to cope with the needs of the sick and wounded. There was scant provision for the alleviation of suffering and distress of the dependents of those who gave their lives in the war. There was little help toward the readjustment of thousands whose lives had been disrupted by service and who were in need of rehabilitation. It was a dark age for the returning defenders of democracy. On top of this came a postwar depression. There was no national agency, such as today's Veterans Administration; veterans' hospitalization was inadequate and unsatisfactory.

Such was the Herculean task which faced the infant American Legion and its legislative committee. The early years, 1919 to 1933, saw unrelenting legislative efforts by The American Legion in the attainment of such objectives as the creation of the Veterans' Bureau and then the Veterans Administration; realistic compensation programs for the disabled and their dependents; hospitalization for the disabled; adjusted compensation for the veterans; education programs for the service-connected disabled; and other veterans' benefits previously unknown.

In addition to beneficial legislation affecting veterans and their dependents, the National Legislative Committee's work in the fields of Americanism and national security also bore fruit. Its endeavors contributed to the passage of anti-subversive laws, as well as legislation to strengthen our military forces, including the National Guard and Organized Reserve. These were busy years for the Committee, and during that period The American Legion was recognized as having the most powerful and effective legislative lobby in Washington.

Compared to the standards of the time, the veterans' program at the beginning of 1933 was in excellent condition, but our nation was at the bottom of a great depression. The Legislative Committee of The American Legion had been so successful that economy-minded members of Congress, reinforced by the National Economy League, worked for the passage of "An Act to Maintain the Credit of the United States" which became Public Law 2 with the President's signature on March 20, 1933.

Passed by Congress without a hearing—with no opportunity being given The American Legion to oppose it—this measure contained the following provision: "All public laws granting medical or hospital treatment, domiciliary care, compensation and other allowances, pension disability allowance, or retirement pay to veterans and dependents of the World War are hereby repealed." One stroke of the pen wiped out 13 years of American Legion legislative effort.

Legislative Counter-Offensive Successful

Though rocking from the punch, The American Legion quickly organized a legislative counter-offensive. With one out of every five veterans in its ranks to give it strength, The American Legion took to the highways and byways and descended upon the crossroads of the nation to advise the people of the terrible consequences of Public Law 2. Meanwhile, the National Legislative Committee organized its plan of attack for the 1934 session of Congress. Overwhelming veteran support, combined with the Legislative Committee's testimony before Congressional committees, brought about a complete reversal by Congress on March 28, 1934. This measure became law over the President's veto. A great amount of credit for this notable achievement must be given to the indomitable spirit and courage of then National Commander Edward A. Hayes (deceased) of Illinois.

GI Bill of Rights

The greatest single legislative achievement of The American Legion was the enactment of the Servicemen's Readjustment Act of 1944, more popularly known as the GI Bill of Rights. Not only is The American Legion universally recognized as the originator of this omnibus bill, but also as the force which overcame political opposition by massing public opinion in favor of the measure.

With approximately fifteen million men and women in the armed services of the United States in World War II, The American Legion resolved that its post-World War I experiences would not be repeated. The painful memories of disabled men waiting for more than five years for legislation which would permit prompt and fair adjudication of their rights to hospital care and compensation inspired American Legion leaders to work for the enactment of this omnibus law which has been described as the most comprehensive piece of legislation dealing with veterans' affairs ever enacted.

The GI Bill of Rights embodied all that The American Legion had learned during a quarter century and its preparation involved many months of careful research, the analysis of convention mandates, exchange of ideas with experts in the military, naval, educational, financial, employment, and unemployment compensation fields. Of inestimable value in drawing up this legislation were the experience records of the National Rehabilitation Commission of The American Legion. The GI Bill of Rights is best described by its several titles: (1) Hospitalization, claims, and procedures; (2) Education of veterans; (3) Home, farm, and business loans; (4) Employment of veterans; (5) Readjustment allowances for unemployed; (6) General administrative and penal provisions.

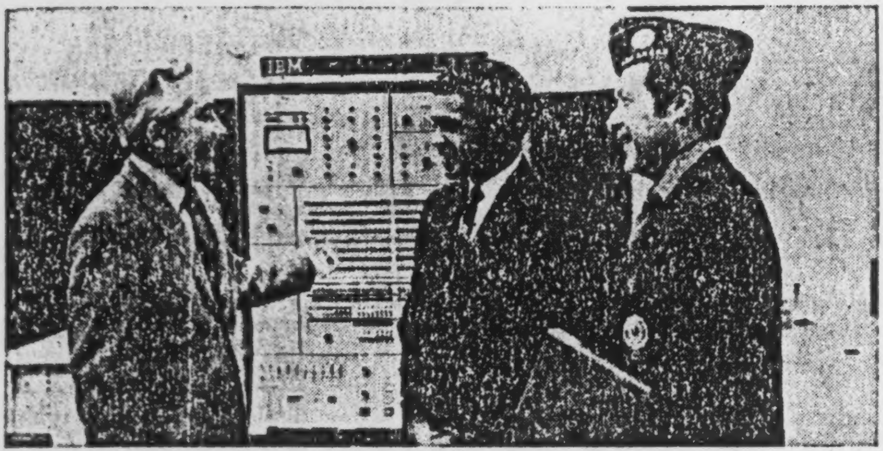
The Veterans Administration was made the focus of most operations under the law and the point of contact for the veteran in matters falling under other government jurisdictions. The drafting of this legislation has been called the greatest single feat of statesmanship in the history of The American Legion. The methods by which it was guided through Congress and to the President's desk demonstrated the strong links which bind The American Legion to all segments of American life. Not only was the public made thoroughly aware of the complex content of this Legion-sponsored bill, but the nation's legislators were kept fully informed for several months as to the sentiments of their constituents on the measure.

With the commitment of American troops to meet communist aggression in Korea in 1950 and in South Vietnam in 1964, similar programs supported by The American Legion were enacted for the benefit of the veterans of the periods of these armed struggles.

President Franklin D. Roosevelt signs The American Legion-authored GI Bill of Rights for World War II veterans, June 22, 1944. Witnessing the historic event are American Legion leaders and key members of the U.S. Senate and House of Representatives.

VIII. *Economic*

THE ACTIVITIES AND PROGRAMS under the jurisdiction of the National Economic Commission are as old as The American Legion itself. However, these activities and programs were not grouped into one commission



The opening of the decade of the 1970's found The American Legion once again marshaling its resources to assist a new generation of war veterans in finding jobs or the necessary training for skills in demand.

until action was taken by the National Executive Committee in November 1947. The program started when the young World War I veteran, with sixty dollars in his hand, faced the problems of finding a job and a home and meeting the other economic questions facing every man who returns from the service of his country. One of the earliest American Legion economic programs was that of assistance in finding employment. Closely allied with this was the program of obtaining a preference for veterans in federal employment.

The American Legion has for many years advocated certain preference for veterans in federal employment. The passage of the Veterans' Preference Act of 1944 was the culmination of years of hard work by the major veterans' organizations, the Civil Service Commission, and the Committee on Civil Service in both the Senate and House of Representatives.

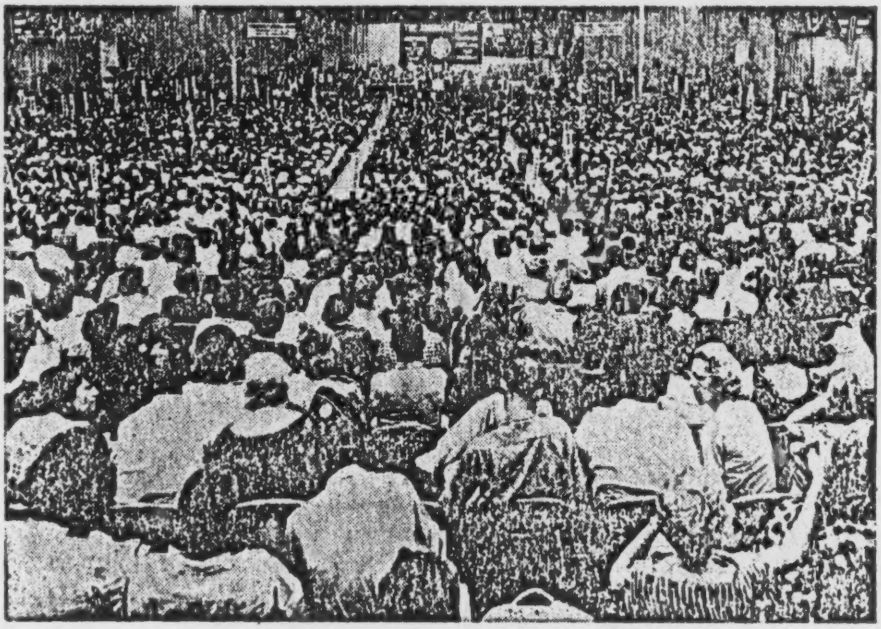
The American Legion has a deep interest in the provisions of the Veterans' Preference Act of 1944, as amended, because this statute was enacted with the Legion's unqualified endorsement and, in fact, The American Legion itself was instrumental in the drafting of the language of this legislative measure. It is interesting to note that this law was enacted with but a single dissenting vote.

In spite of the continued opposition to such preference, The American Legion wrote and had approved the first Executive Order establishing preference by giving five points to veterans and ten points to disabled veterans in competitive examinations for federal employment. Thus, the qualified compensable service-connected veteran was able to get to the top of the certificate of eligibles for federal employment.

Wagner-Peyser Act of 1933

The first legislation which provided federal assistance to veterans in finding employment was included, at the request of The American Legion, in the Wagner-Peyser Act of 1933. This act provided for the development and maintenance of a national system of employment offices to include a veterans' service to be devoted to securing employment for veterans.

The current program for veterans' employment is built around legislation sponsored or supported by The American Legion which provides for effective retraining, job counseling, and employment placement service for veterans. Such legislation also requires employment policies to be promulgated and administered which will provide veterans the maximum of job opportunity.



Typical of American Legion National Convention scenes is this of the opening session of the 1960 conclave at Miami Beach, Florida.

IX. *War Time Service*

AN ORGANIZATION of war veterans, The American Legion has found itself in a position to perform vital services to community, state, and Nation immediately prior to and during subsequent periods of armed conflict.

More than a year before the United States entered World War II, The American Legion began organizing for more effective cooperation with local, state, and national defense activities. In February 1941, a commission was sent to Europe at the expense of The American Legion to study civilian defense under modern war conditions. Heading this commission was then National Commander Milo J. Warner. Upon its return the commission reported at a special meeting of the National Executive Committee and The American Legion published and distributed 150,000 copies of a manual on civilian defense—the first such information to be issued in this country.

After Pearl Harbor, American Legion posts threw themselves into the task of strengthening the homefront to assure victory. The American Legion collected necessary salvage; engaged in a nationwide program of training instructors for air raid wardens, auxiliary police, and firemen; established blood banks; collected cigarettes and gifts for men in camps and overseas; located skilled workers for essential services and industry; cooperated with the Red Cross and the USO; provided entertainment for hospitals at home and operated canteens for men in uniform; staged bond drives and invested post and personal surplus funds in U. S. War Bonds; cooperated with the F.B.I. in helping to check sabotage and espionage; recruited flying cadets and volunteers for the various branches of the armed forces. These and many other services were volunteered by American Legion posts and members. Thousands of American Legionnaires themselves returned to active service with the armed forces and saw action on every front.

For three years prior to the outbreak of hostilities in Korea, The American Legion warned of the spread of communism in Asia and called for a Universal Military Training program to strengthen our Nation in dealing with this problem. However, an America enjoying the first sweet taste of victory and peace after World War II would not heed the Legion's alarm.

Throughout the period of hostilities in Korea, The American Legion supported the measures necessary to bring about a total military victory, but the advocates of political settlement prevailed. The consequences of such a decision are still to be weighed by future historians.

On August 5, 1964, an incident in the Gulf of Tonkin changed the role of the United States in its assistance to the people of South Vietnam. Overnight, U. S. armed forces personnel became more than advisers to South Vietnamese military units, and another generation of Americans answered the call to defend the cause of freedom.

Leading the Nation's expressions of support for the men and women in uniform were American Legion Posts which established elaborate programs of contact with military personnel, providing mail, gifts, and the hospitality of thousands of posts throughout their tours of duty. The Legion also undertook a gigantic program of personal contact to help ease the problems facing the men and women of the armed forces as they returned to civilian life.

X. *American Legion Publications*

THE FIRST VENTURE of the national organization of The American Legion into the publishing field was *The American Legion Weekly,* which made its debut with the July 4, 1919, issue. The weekly was published until June 18, 1926, when it was succeeded by *The American Legion Monthly.* In June 1937, the publication's name was changed to *The American Legion Magazine,* which today ranks as one of the leading magazines in America. This publication goes to every Legionnaire.

In January 1935, there also was established a monthly tabloid, *The National Legionnaire,* which also was sent to every member. This publication was devoted entirely to news of American Legion activities and carried no fiction stories or advertising. After fourteen years as a separate publication *The National Legionnaire* was merged in February 1949, with *The American Legion Magazine.*

LEGION
LEGION
LEGION

The American Legion Magazine which is received monthly by each member of the world's largest veterans' organization is recognized as one of the nation's leading publications.

XI. *American Legion Auxiliary*

ESTABLISHMENT OF A women's auxiliary to The American Legion was provided for by the First National Convention in 1919 at Minneapolis, and when the 1920 Convention opened in Cleveland, Ohio, 1,342 local units had been formed and 11,000 members enrolled under the tentative name of Women's Auxiliary of The American Legion.

Intensive organization followed the Cleveland convention with the number of units being increased to 3,653 and the membership to 131,000 within a year.

The American Legion Auxiliary

MIRIAM JUNGE, *National Secretary*

CHAPTER IV

BIRTH AND GROWTH

FOR NEARLY EVERY MAN in World War I who endured the dangers and hardships of camp, ship, and battlefront, there was a woman serving at home to help make possible America's victory—his wife, mother, sister or daughter.

After the war had been won and the men of the armed forces had banded together in The American Legion to carry forward their services to country in peace time, it was only natural that the women of their families should desire to continue to serve with them. The result was the American Legion Auxiliary, the largest and most influential women's organization of its kind in the world today.

The establishment of an Auxiliary to The American Legion was provided for by the first national convention of The American Legion in 1919. By the time of the 1920 national convention, 1,342 local units of this Auxiliary had been formed and intensive organizations efforts were authorized. The first national convention of the Auxiliary was held in Kansas City, Mo., in 1921, at which time the name "American Legion Auxiliary" was adopted and the first national officers elected.

The Auxiliary grew from a first year enrollment of 121,000 to approximately 500,000 at the beginning of World War II. After women of World War II and Korean War families became eligible, the enrollment rose rapidly to a record of 1,001,545 in 1955, and since has remained well above the 950,000 mark. When the eligibility of women of Vietnam Hostilities families became a reality, we expanded our horizons on membership. The number of local units of the Auxiliary is approximately 13,000. Auxiliary organization, local, state and national, parallels that of The American Legion. Auxiliary national headquarters are maintained in Indianapolis, Ind., with an additional office also maintained at The American Legion building in Washington, D. C.

PURPOSE OF THE AUXILIARY

THE AMERICAN LEGION AUXILIARY has one great purpose, "to contribute to the accomplishment of the aims and purposes of The American Legion." Except for the addition of those words, the Preamble to its national constitution is the same as that of The American Legion.

The American Legion Auxiliary sets up no policies of its own, always following those of The American Legion. Its activities are designed to carry out the parts of The American Legion's program which can best be accomplished by the work of women.

THE AMERICAN LEGION AUXILIARY MEMBER

MEMBERSHIP IN the American Legion Auxiliary is limited to women who have direct personal connection with World War, Korean War, or Vietnam service through a member of their immediate family who served with the Armed Forces during those wars, or through their own service with the Armed Forces. Upon establishment of eligibility, such women may become members of a local unit of the Auxiliary. A member of a local unit is also a member of the state department and the national organization, just as a citizen of Chicago is also a citizen of Illinois and of the United States. By the payment of dues in the local unit a member also contributes to the support of the state and national organizations.

Three Classes of Women Eligible—All women who are eligible to membership in the American Legion Auxiliary come under one or more of the three following classifications:

(a) Mothers, wives, sisters, daughters and granddaughters of members of The American Legion.

(b) Mothers, wives, daughters, sisters, and granddaughters of all men and women who were in the Armed Forces of the United States between April 6, 1917, and November 11, 1918, or between December 7, 1941, and December 31, 1946, or between June 25, 1950, and January 31, 1955; August 5, 1964, to May 7, 1975*, or who, being citizens of the United States at the time of the entry therein, served on active duty in the Armed Forces of any of the governments associated with the United States during either of said World Wars, and died in line of duty or after honorable discharge.

(c) Women who through their own wartime service are eligible to membership in The American Legion.

The only form of membership that is authorized is active membership, of which there are two classes, senior and junior, and there can be no granting of special or honorary membership for any purpose or reason whatsoever.

Once accepted as an American Legion Auxiliary member, women eligible under classification "a" may continue their membership from year to year whether or not their male relative continues to be a member of The American Legion. The fact that her service relative is no longer a member of The American Legion does not compel the Auxiliary member to lose her Auxiliary membership.

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* Congressional action pending to amend Section 5 of the Charter of The American Legion. If adopted, the dates for the Vietnam era will be Dec. 22, 1961 to May 7, 1975.

The term "wife," as used in the eligibility clause, does not necessarily mean that the wife occupied that status at the time her husband was in war service. Any woman who marries a member of The American Legion at any time is eligible to membership in the American Legion Auxiliary. The term "wife" also includes widows.

An American Legion Auxiliary member eligible through a Legionnaire husband does not lose her Auxiliary membership if she should be divorced. As long as she maintains her membership she is eligible through her former husband, but should she drop her membership she has no eligibility for re-enrollment through his service.

At the 1970 National Convention in Portland, Ore., The American Legion enlarged the eligibility provisions of the American Legion Auxiliary by including granddaughters. In the 1970-71 year, granddaughters became members for the first time. Nearly 100,000 Junior members are enrolled in the American Legion Auxiliary, many of them granddaughters.

THE AMERICAN LEGION AUXILIARY UNIT

THE BASIC organization of the American Legion Auxiliary is the local unit. All Auxiliary members must hold membership in some local unit. It is through the local units that the department and National program is carried into concrete action and through which the American Legion Auxiliary exerts its power for service to The American Legion and the nation. The primary purpose of an auxiliary unit is to aid The American Legion post to which it is attached in accomplishing American Legion projects in the community. The auxiliary unit is an auxiliary body to The American Legion post and takes the post's name and number. A unit can be formed only under the authority of and in connection with an American Legion post, although under certain conditions the unit may continue to exist after the post to which it is attached has ceased to function.

Ten new senior (adult) members are required to form an American Legion Auxiliary unit. The unit must take the name, number and location of The American Legion post to which it is attached, and these appear on the unit charter. When a post changes its name and number, the unit attached to that post must also change its name and number to correspond with those of the post.

The cancellation or revocation of a post charter does not invalidate the charter of its auxiliary unit. The unit may continue to operate, bearing the name and number of the post to which it was attached. In this status it is known as a "widow" unit.

The unit should always remember that it is an auxiliary to its post and its first purpose should be to forward the program of the post. It must never take action which conflicts with the stand of the post and should never undertake an important project without the post's approval. The unit should regard its connection with the post as a distinct honor. It should strive unceasingly to carry out the national constitution's pledge "to participate and contribute to the aims and purposes of The American Legion."

Officers of an American Legion Auxiliary unit corresponds to those of an American Legion post.

President
Vice President
Treasurer
Secretary
Historian
Chaplain
Sergeant-at-Arms

Dues are paid to the unit, which forwards department and National dues to the department headquarters.

AMERICAN LEGION AUXILIARY ACTIVITIES

THE ACTIVITIES of the American Legion Auxiliary are designed to support and supplement the work of The American Legion. They parallel closely and are completely coordinated with the activities of The American Legion. Wherever in The American Legion's program the work of women can be helpful the Auxiliary will be found energetically at work.

NATIONAL HEADQUARTERS

The American Legion Auxiliary maintains its National Headquarters in Indianapolis, Indiana, in a part of the War Memorial Commission Plaza of the State of Indiana. Housed on the third and fourth floors of the state-owned building at 777 North Meridian Street, it is situated across the mall from the National Headquarters of The American Legion. Offices of the three National Officers (the National President, National Secretary, and National Treasurer) and the staff are located there with 14 members of the staff assisting the National Officers.

In addition, the American Legion Auxiliary maintains an office in Washington, D.C. in The American Legion Headquarters there. A Director of that office and secretarial staff complete that branch. The National President and her personal secretary relate themselves to the correspondence of that office and the official itinerary of the National President.

In the National Headquarters office, the National Secretary and her staff correspond with the Departments and National Committees and handle details of National meetings. Inventory of supplies for Departments and committees is also handled in this office. A complete file of Unit Charter information is maintained as well as microfilm records of all membership applications and remittances of memberships. The National Treasurer's office, as its name implies, handles disbursements and the income of the Auxiliary as well as records of membership. A permanent file of the work of the Auxiliary is also maintained in National Headquarters.

The Washington Office handles contacts with government agencies and national organizations with offices in Washington, as well as programming assistance to National Chairmen, especially the Girls State and Women's Forum on National Security.

Considering the large membership of the organization, the staff of the National Headquarters is relatively small. This is to the credit of our Auxiliary—and is due largely to three reasons: 1. reliance on the Department offices and staff for much of the detailed record-keeping; 2. concentrated mechanization of the work of National Headquarters; and 3. appreciated assistance by the program divisions of The American Legion National Headquarters in many instances in any given year.

AMERICANISM

The Americanism work of the American Legion Auxiliary includes all activities tending to perpetuate American ideals and to uphold the principles of American democracy. The Auxiliary's work is largely educational in nature, the teaching of good citizenship, loyalty and patriotism. Auxiliary members study the American form of government in their Units and strive to make their homes centers from which American ideals will radiate. Through their contacts with young people they are able to exert wide influence on behalf of good citizenship and patriotism.

Auxiliary Americanism activities include sponsoring of study classes on the Constitution, helping in community observance of patriotic holidays, sponsoring citizenship classes for aliens, presenting flags and flag codes to schools, sponsoring Girl Scout troops, Camp Fire Girl groups, and similar youth organizations, presenting Americanism awards in the schools, and holding Americanism meetings and community forums. Citizenship education with emphasis on youth-related activities is an on-going thrust.

Beginning in 1966, the Auxiliary annually has sponsored a Freedoms Foundation seminar for graduate study of teachers (with degree credit) centered on Americanism and given by accredited professors at Freedoms Foundation. Thirty or more teachers each year are awarded scholarships to this study course, each with full expenses paid and each scholarship in the amount of $550. A continuing part of the total Americanism program is the annual sponsorship in all Departments of the Girls State program and the sponsorship nationally of the Girls Nation program. This outstanding program in citizenship training is discussed in another section of this book.

CHILDREN AND YOUTH

The American Legion Auxiliary's Children and Youth program is completely coordinated with that of The American Legion. Its purposes and activities in this field are the same as those of The American Legion. Much of the actual work of contacting needy children in their homes and bringing to them the necessary aid is carried out by the women of the Auxiliary.

The International Human Assistance Programs, which gives assistance to children with heart problems requiring surgery, is a program in Children and

Youth supported by the American Legion Auxiliary without the assistance of The American Legion. Funds raised for this endeavor are divided equally between International Human Assistance Programs, Inc. and the Metropolitan Medical Hospital in Minneapolis, Minnesota where the actual surgery is done. IHAP provides the transportation for the child and an escort.

Important financial support is given by the Auxiliary's national organization to The American Legion's national Children and Youth program. For example, since 1957 an annual contribution of $20,000 has been given to the Children and Youth Division for support of their programs and an additional $10,000 is donated by the Auxiliary to the National Child Welfare Foundation.

COMMUNITY SERVICE

American Legion Auxiliary Units always have been very active in the community service field, every Unit being expected to carry out at least one project for the benefit of its community each year.

Community service projects successfully carried out by the American Legion Auxiliary, either alone or in cooperation with other organizations include:

Community Beautification: beautifying parks, playgrounds, areas around nursing homes, and conducting community clean-up and paint-up campaigns.

Community Health: cooperating with local health authorities, providing community clinics, nurses, drinking fountains, ambulances, hospital equipment such as incubators, training in life-saving procedures, assisting in the removal of architectural and attitudinal barriers facing the handicapped, and aiding local campaigns of national health organizations.

Recreation: helping to provide playgrounds and equipment, swimming pools, youth activity centers, and other recreational facilities.

Safety: cooperating with the National Safety Council in campaigns against accidents on the highways, streets, and in the home.

Community Councils: promoting community service councils composed of all civic, patriotic, and fraternal organizations as the best way of securing community improvements.

EDUCATION

The American Legion Auxiliary works very closely with The American Legion to offer educational opportunities to all people, especially the youth.

The "Need A Lift?" booklet written and printed by The American Legion is highly recommended by the Auxiliary for its value as a research source on scholarships, listed state by state, as a source of informational aid to all students who are looking for career information and guidance pamphlets, and additional information whereby the student can find other subject matter on education quickly and easily. "Need A Lift?" contains information on financial aid programs and loans available through the federal government.

Annually the National President, on behalf of the National Organization, awards 10 scholarships designated as the National President's Scholarship. These are awarded by areas (geographical designations) with 2 scholarships in each area, one for $1,500 and one for $1,000 to a son or daughter of a veteran. The Eight and Forty, a subsidiary of the American Legion Auxiliary, offers several scholarships annually to a registered nurse who wishes to extend her knowledge into the field of respiratory illnesses. Information and pamphlets are available from The American Legion and American Legion Auxiliary on the G.I. Bill, the Jr. G.I. Bill, the Vietnam G.I. Bill, Social Security and widow's benefits.

The American Legion and the American Legion Auxiliary now have a coordinated committee composed of key persons, from both organizations, whose purpose it is to satisfy themselves and the membership that The Legion and Auxiliary are doing all they can to aid the field of education. They study the present program to see where improvement is needed and changes that must be made. The National Coordinated Committee urges Post and Unit participation in a similar committee to better their relationship with each other and the community in which they reside.

The National Committee is urging all Posts and Units to assist their communities in Career Education by whatever way they can that fits their locale. The Committee feels that all people cannot get a higher education, and to have a useful and productive place in society, each individual should have instruction and guidance in finding work in their life that is satisfactory to them.

Many local Posts and Units, as well as Departments, have scholarships available to students, and usually the requirement is that the student be a child of a veteran. The Legion and Auxiliary supports National Education Week, awards to students and teachers, and all programs of Americanism within the schools. Many pamphlets are available on the Education Program and can be secured by writing the National Headquarters and requesting them.

GIRLS STATE

Girls States, similar to The American Legion's Boys States, are sponsored by the American Legion Auxiliary each summer in 50 states, District of Columbia and Panama Canal Zone. Girls who are attending Senior High School and are in the Junior Class are selected for their interest in government and potential leadership qualities to attend the Girls State Session—varying in length from 5 days to 10 days (the decision of the State) and at Girls State as citizens they create and operate a government of their own. Similarly, from each Girls State session, two citizens are chosen to go to Girls Nation in Washington representing their State as Senators and at Girls Nation they create and operate their own government parallel to our own Federal Government. Each year the opportunity of citizenship training through Girls State comes to 25,000 young women in our nation.

JUNIOR ACTIVITIES

The American Legion Auxiliary's Junior members, those under the age of 18, function in all Auxiliary programs, within special activities designed for their age groups. Membership records reflect more than 104,000 daughters, granddaughters, and sisters of Legionnaires in the Junior ranks. Formed into Junior groups within the Units, under the guidance of a Senior Advisor, these young ladies add to the services and community activities of The American Legion and the American Legion Auxiliary and in turn receive training in the organization's work and in good citizenship.

LEGISLATION

The American Legion Auxiliary has no legislative program of its own, devoting its legislative efforts entirely to the support of The American Legion's program. National, department and unit legislative committees are very active in winning public support for American Legion endorsed legislation and in making this support effective in state legislatures and in Congress. American Legion leaders give a generous share of the credit for The American Legion's legislative success to the members of the American Legion Auxiliary. In the past several years, American Legion Auxiliary members have been saluted by The American Legion for their support of and subscriptions to the publication "Legislative Bulletin."

MEMBERSHIP

Like The American Legion, the American Legion Auxiliary carries out a vigorous membership campaign each year. A majority of local units conduct their campaigns during November and December, then continue active membership enrollment through the winter and spring months.

The Auxiliary has published a brochure on the programs of the Auxiliary entitled, "You and the American Legion Auxiliary." You may secure copies of this brochure by writing National Headquarters. The brochure was designed to both educate the membership, as well as an attractive membership promotion item. Also available is a bulletin on membership which originated from the Fiftieth Anniversary observance—this Bulletin explains the operation of the American Legion Auxiliary entitled "Who, What, When, Where and Why"? In addition, the pamphlet "How to Organize a Unit" has been updated and reprinted and is available, also. To assist Units in enrolling new members, a brochure entitled "Have You Met Her?" has been published and is available through Department Headquarters.

MUSIC

Music plays an important part in Auxiliary activities. Units open and close their meetings with patriotic music and have group singing at their meetings and many have organized choral groups who make frequent appearances in American Legion and Auxiliary programs, meetings of other organizations, and on Radio and Television. At some National Conventions

Senior and Junior musical contests were held. A Girls State Chorus was a feature of the 1974 National Convention and in 1975 the sponsorship of musical contests was resumed.

NATIONAL SECURITY

In the firm belief that the foremost obligation of our country is to provide for the security of its people, the American Legion Auxiliary works side by side with The American Legion in support of an adequate national defense. The American Legion Auxiliary has always been a powerful moving force through its involvement in programs aimed at keeping America strong—militarily, economically, and spiritually. During the years following the first World War, when a radical pacifist movement urging the total disarmament of the United States was claiming support of the women of America, the American Legion Auxiliary campaigned effectively to refute these claims. The Auxiliary's effort was a contributing factor in the maintenance of a skeleton defense framework during the years between the two World Wars.

The American Legion places top priority on national security issues and through mandates at its National Conventions, strives to maintain the security and protect the interests of the United States. The definite objectives of the national security program of both organizations are outlined annually.

National Security forums, conferences, and meetings, sponsored by the American Legion Auxiliary at national, state and local levels provide the opportunity to inform members and the general public of the need for an ongoing nationwide program and the importance of preparedness at all times. By means of speakers, press, radio and television, the Auxiliary is constantly at work to present The American Legion's national security program to the public. Women being the most receptive field for the spread of sentiments against military training and defensive preparations, the American Legion Auxiliary is of vital importance in winning women's support for military manpower and defense measures deemed necessary by The American Legion.

Each year, since 1952 through the aid and encouragement of the Auxiliary, the Women's Forum on National Security meets in Washington, D.C. to study and evaluate our nation's needs for preparedness and defense. Prior to this, the Auxiliary for some twenty-six years was a part of the "Women's Patriotic Conference on National Defense." The purpose of the forum is to inform, arouse and activate public opinion among women leaders throughout the nation. On alternate years the American Legion Auxiliary serves as chairman; while other years another of the 15-member organization assumes responsibility for the annual program. Top government officials, scientists, educators and other public figures are invited to participate and share their views on the current status of our national security.

The Auxiliary actively supported the men fighting the Vietnam War. More than $100,000 was sent by The American Legion and Auxiliary to the

Vietnam Relief Fund as support of the Civic Action Teams. Transistor tape recorders were sent to field hospitals and money was contributed to an orphanage established by American troops as well as numerous other projects. Both organizations joined in a massive letter writing campaign in behalf of prisoners of war and those missing in action. Since the release of POW's in 1973, the campaign has continued in behalf of those unaccounted for and missing in action.

In recent years much emphasis and support has been given The American Legion's Crime Resistance and Law and Order programs by the American Legion Auxiliary to strengthen America at the community level.

FOREIGN RELATIONS

In 1967, the American Legion Auxiliary chartered its first foreign Department, the Philippines. Every other one of its 54 Departments corresponds to one of the 50 states, or two overseas territories (the Panama Canal and Puerto Rico) or the District of Columbia. However it does have local Units in Canada, Costa Rica, France, Germany, Japan, Mexico and the Republic of China.

Auxiliary members, dedicated for service to their community, state and nation, long have promoted community service also among the community of nations. Between World Wars I and II, these efforts were programmed through the Auxiliary's membership in a federation of Auxiliaries to veterans organizations among the Allied Powers known as FIDAC ("Federation Interalliee des Anciens Combattants"). When this federation fell apart at the outbreak of World War II, the American Legion Auxiliary converted its National FIDAC Committee into a National Pan American Study Committee to foster hemispheric solidarity. Each year, beginning in 1941, it focused a national study program on a different one of the member nations in the Pan American Union, its people, language, history, customs, art, music and culture.

In 1956, a voluntary self-help project was introduced into this program. This is funded not by dues but by "seeding monies" raised by interested members and Units of the American Legion Auxiliary. CARE, Inc. serves as its purchasing agent, conveyor belt for supplies and supervisor at the project sites. Labor is provided by citizens of the communities in which these projects have been activated. Since 1956, these self-help projects have burgeoned from an average investment of about $1,500 per annum to around $55,000 per year. Never has the National Organization set a specific goal for its Units to meet. The emphasis is not on dollars, but on collections of pennies, and the power of the penny is self evident in the accomplishments listed below.

In the early 1960's the Auxiliary changed the name of this program to "Foreign Relations" both to conform to the terminology which The American Legion used and to more accurately define its activity as being more than a study program. No longer is it confined to the area of Latin America. Projects vary annually. Here are some examples:

Vocational and educational tools have been provided to students in CHILE, COLOMBIA, COSTA RICA, HAITI, HONDURAS and PANAMA; and seeds and fertilizers to farmers in BELIZE. Earthquake devastation has been repaired in CHILE and GUATEMALA and electric power brought to villages in KOREA. Schools and classrooms have been built in the DOMINICAN REPUBLIC, INDONESIA, NICARAGUA, PERU and the PHILIPPINES; a village sanitation project introduced to EL SALVADOR, and pure water projects to BOLIVIA, ECUADOR, KENYA and the PHILIPPINES. Food canning and preservation facilities have been provided to the DOMINICAN REPUBLIC and GUATEMALA, health clinics to KENYA, a maternity and pediatrics hospital to MALAYSIA and a community center to HONG KONG. All of these, and many other projects are still bearing fruit because once a project is funded, and the peoples have the means with which to help themselves, the American Legion Auxiliary moves on to another need in another part of the world community. If poverty breeds war then the Auxiliary is attacking one of war's causes at its source.

POPPY

One of the most important of the American Legion Auxiliary's activities is the supervision of the making and distributing of memorial poppies, which are worn throughout the nation on Poppy Day each year in tribute to the war dead. Traditionally, the first poppy is presented to the President of the United States.

The poppies are made by disabled veterans of all wars, working in veterans' hospitals in every part of the country and in convalescent workshops maintained by the American Legion Auxiliary. The work is beneficial to the veterans both because of the money they earn and because of its value as occupational therapy. Approximately 6,000 disabled men are given employment in the program, and about 19,000,000 poppies are made. Manufacture is in charge of the state organizations of the American Legion Auxiliary, except in a few states where The American Legion directs the program.

On Poppy Day, generally observed during the week before Memorial Day, workers from American Legion Auxiliary units and cooperating young women's organizations, all of them unpaid volunteers, distribute the poppies on the streets of cities and towns throughout the nation. Some 150,000 volunteers serve each year. Contributions received for the poppies go entirely to the Veterans Affairs and Rehabilitation and Children & Youth funds of the American Legion Auxiliary, forming the major source of financial support for these vast activities. The bulk of the money stays in post, unit and department treasuries for use in local rehabilitation and relief work during the following year.

To "honor the war dead and aid war's living victims" is the purpose of the poppy program.

COMMUNICATIONS

All of the activities that come under the realm of Public Relations for the American Legion Auxiliary with the outside media and some of the activities of inner communications in the organization come under the jurisdiction of the Communications Committee. The largest part of this committee's activities is geared to furnishing to the media (press, radio & television) materials on each of the programs of the American Legion Auxiliary, both locally and nationally.

In the field of press, radio and television, the Departments annually salute local newspapers, radio and television stations for their aid in publicizing the work of the Auxiliary. The Golden Mike and Golden Press Awards were initiated by the American Legion Auxiliary in support of the American Legion's Child Welfare Resolution calling for the emphasis of Juvenile Decency over Juvenile Delinquency in the nation's communication media. The awards are designed specifically to give recognition to the efforts of local broadcasters and newspaper editors and feature writers in presenting programs and articles of outstanding merit "in the interest of youth." They were further designed to encourage members of the media to attain the highest standards in local broadcasting and reporting. The American Legion Auxiliary presents two Golden Mike and two Golden Press Awards nationally each year. The Golden Mike Awards are presented-one to the best RADIO program in the interest of youth and one to the best TELEVISION program in the interest of youth. The Golden Press Awards are presented to the best FEATURE ARTICLE in the interest of youth and one to the best EDITORIAL in the interest of youth.

A Communications Guide Book is made available from the National Headquarters upon request and is designed to be a tool to aid local Communications Chairmen in their publicity assignments.

As another Communications tool, National Headquarters makes available a Poppy Day Booklet containing historical data for the information of the local Unit. A small newspaper entitled POPPY DAY NEWS is also available by the National Organization to assist local Communications Chairmen in publicizing Poppy Day.

VETERANS AFFAIRS AND REHABILITATION

The American Legion Auxiliary's work for the disabled veterans of all wars follows and supplements The American Legion's rehabilitation program. Auxiliary support is given to all American Legion efforts to secure the best of care and just compensation for the disabled, and in addition the American Legion Auxiliary carries out projects which add to the comfort and speed the recovery of these veterans. It is the women of the Auxiliary who do much of the actual contacting and aiding of veterans in the hospitals and in their homes.

One of the finest services of the American Legion Auxiliary is given in the Veterans Administration Hospitals, and Non-VA Hospitals, where volunteer workers, who are especially trained for their tasks, go into the hospitals regularly, visiting the patients and extending many forms of aid to them.

Christmas "gift shops" operated by the American Legion Auxiliary in veterans' hospitals bring the joy of Christmas giving to the patients. These shops, operated by the departments in which the hospitals are located, are stocked with gift articles donated by the Auxiliary. The disabled veterans select gifts for members of their families and these are mailed to their homes, without cost to the veterans and in his name only.

In 1966, a new program which had been developing for several years was put into action. In an effort to meet the needs of the veteran returning to the community, the American Legion Auxiliary inaugurated a "new" service entitled "Field Service Volunteers." This is not actually a new program but a development of the "personal contact and follow-up service" which has been a program of the local units since the inception of the Auxiliary. However, changes in medical treatment of patients, benefits to veterans through Social Security and other federal legislation, the establishment of nursing homes, all have pointed to the need to enlarge the program and establish a basis for training volunteers similar to that used to train Volunteer Hospital Workers. By action of the 1974 National Convention, a program of Home Service, a community volunteer program for the Veteran and his family, was established.

To facilitate the training of all volunteers in the rehabilitation program a revised "Guide for Volunteers in Rehabilitation" was made available to the membership. This manual includes information, rules and ethics not only for Volunteer Hospital Workers and Field Service Volunteers but also for VolunTeens, American Legion volunteers and non-affiliated volunteers recruited by the American Legion Auxiliary.

A pamphlet entitled "The Patient Returns to the Community," a guide for a volunteer service program in the community, was published by the Veterans Administration and is an excellent and necessary supplement to the American Legion Auxiliary Guide in the development of the Field Service Volunteer program.

The various phases of the rehabilitation program occupy a large portion of the Auxiliary's energies and resources and the work is considered of primary importance to the American Legion Auxiliary as well as to The American Legion.

The Auxiliary invests each year over four million dollars for the welfare of sick and disabled veterans. Hospital Volunteers give 1,600,000 hours of service. In addition to this, the National American Legion Auxiliary annually presents $15,000 to The American Legion for rehabilitation work.

In the fall of 1979, a series of eight Regional Program Conferences replaced the Area Conferences held previously. These American Legion and Auxiliary Regional Conferences will facilitate early planning and local leadership development in the following program and service activity areas:

Children and Youth
Americanism
Education
Veterans Affairs & Rehabilitation
Leadership
Membership
Legislative
Public Relations

The basic objectives of these Regional Leadership Conferences, in addition to reducing the cost of attending various conferences, is to encourage attendance by District and Post or Unit leadership and to provide a format wherein an individual could receive instructions in any program of The American Legion or Auxiliary in one weekend. Noted speakers are featured in each of the sections of the conferences.

Departments shall be assigned to the Regional Conferences as follows:

Region #1	*Region #2*	*Region #3*	*Region #4*
Connecticut	Delaware	Florida	Alabama
Maine	D. C.	Kentucky	Arkansas
Massachusetts	Maryland	Georgia	Louisiana
New Hampshire	New Jersey	North Carolina	Mississippi
Rhode Island	New York	South Carolina	Oklahoma
Vermont	Pennsylvania	Tennessee	Texas
	Virginia		
	West Virginia		

Region #5	*Region #6*	*Region #7*	*Region #8*
Indiana	Kansas	Arizona	Alaska
Illinois	Iowa	California	Idaho
Michigan	Minnesota	Colorado	Montana
Missouri	Nebraska	Hawaii	Oregon
Ohio	North Dakota	Nevada	Washington
Wisconsin	South Dakota	New Mexico	Wyoming
		Utah	

PUBLICATION

THE AMERICAN LEGION AUXILIARY has a national publication, *National News of the American Legion Auxiliary,* which goes to all senior (adult) members bi-monthly. Many state and local publications also are issued.

AUXILIARY EMERGENCY FUND

In 1970, as a National President's project (Mrs. H. M. Davidson, National President) and to be a continuing project of the American Legion Auxiliary, there was established an Auxiliary Emergency Fund. This project was originally funded by interest from a part of an estate bequeathed to the Auxiliary by a deceased Auxiliary member, Helen Colby Small from the Department of Wisconsin, supplemented by gifts from individual Auxiliary members and Departments of the Auxiliary is an emergency fund for Auxiliary members to provide temporary financial assistance (said Auxiliary member must have been a member for the immediate past five consecutive years—including the current year). Applications and information are available in the office of the Department Secretary.

AUXILIARY INSURANCE PROGRAM

In 1970, there was also established (after a study of several years), a Life Insurance Program for American Legion Auxiliary members. Periodically, advertisements and application blanks are carried in the NATIONAL NEWS. The program featured a constant, never-increasing premium with the coverage determined by the age of applicant when insurance is first issued (said coverage not to be diminished or canceled by the company). This insurance is available only to Auxiliary members. For information, you should contact the office of the Department Secretary or National Headquarters. This insurance program has been expanded to include an In-Hospital income program and a heart-cancer-stroke insurance program.

CAVALCADE OF MEMORIES

In 1972 at the National Convention, the American Legion Auxiliary created a special section of national headquarters in Indianapolis—known as the Cavalcade of Memories Room. In this area—which encompasses four rooms at National Headquarters, and houses the memorabilia of the 50-year history of the American Legion Auxiliary. Furnishings have been donated by Departments. In 1973, the major renovation was completed and the area was dedicated at the 1973 Department Presidents and Secretaries Conference. It continues to grow with interesting memorabilia.

EIGHT AND FORTY

THE "EIGHT AND FORTY," officially La Boutique des Huit Chapeaux et Quarante Femmes, is a subsidiary organization of the American Legion Auxiliary. Its membership is limited to women who have been members of the Auxiliary for at least three years and who have performed outstanding service in the parent organization. Special projects of the Eight and Forty are the combating of tuberculosis and cystic fibrosis among children.

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CHAPTER IV

REVIEW QUESTIONS

THE AMERICAN LEGION AUXILIARY

1—Can a woman whose deceased brother was a veteran of World War II but never belonged to The American Legion become a member of the American Legion Auxiliary?

2—Can the daughter of a Legionnaire, age four, become a member of the American Legion Auxiliary?

3—What are the Auxiliary's "Christmas Gift Shops?"

4—Who makes the Auxiliary's Memorial Poppies and who distributes them?

5—What is the name given to the Auxiliary's annual radio-television awards?

Mr. MILLER. Mr. Chairman, and members of the Subcommittee on Taxation and Debt Management, the American Legion is pleased to appear before you today to present its views in support of S. 1167 and S. 1579, proposed legislation that would amend the Internal Revenue Code of 1954 to increase the volunteer mileage deduction to the same level enjoyed by persons engaged in using privately owned vehicles for business and Government activities. The American Legion, perhaps the Nation's largest volunteer organization, strongly encourages the enactment of the proposals of Senator Durenberger and Senator Armstrong to correct an inequity in the treatment of volunteers who use their POV's for volunteer related activities. The Legion and its auxiliary represent more than 3.6 million members who serve their communities and fellow Americans without pay. Many of our members depend upon the volunteer mileage tax deduction to defray a portion of the cost of providing their services to charitable activities. We would like to emphasize that the deduction volunteers take for miles driven is not compensation; rather, it is to help offset the expense of operating an automobile which is being used to conduct volunteer activities. More importantly, however, it is the individuals who are helped by the Legion as well as other volunteer organization programs who are the real beneficiaries of the volunteer mileage tax deduction. But without it and adequate reimbursement, the programs aiding Americans in need might be greatly curtailed.

Presently an inequity exists that threatens to deny beneficiaries those services that they desperately need. The inequity that we are referring to is between the allowable mileage tax rate deduction which can be taken by persons driving for business and the deduction which can be taken by those persons who use their automobiles to conduct charitable activities.

In 1982, this subcommittee was presented with a table showing the anticipated revenue loss from a bill which was introduced by Senator Durenberger, S. 473. The Treasury estimated that the revenue loss, from fiscal year 1982 through fiscal year 1987, would total $573 million. I would invite the subcommittee's attention to that chart, and notice that the anticipated revenue losses increased dramatically from $7 million in the first fiscal year to $55 million in the second fiscal year, and again by $47 million in the third fiscal year. Clearly, something dramatic would have to be at work in order to account for these increases which gradually level out in fiscal years 1984 to 1987. There are several possibilities for the dramatic increases during the early fiscal years as shown by the Treasury's chart. First, there could be a substantial increase in the use of privately owned vehicles for charitable purposes. Second, there could be a substantial increase in the use of privately owned vehicles for charitable purposes and a corresponding increase in the number of individuals claiming the charitable mileage deductions. And, third, the number of charitable miles driven annually might remain constant and thus the increased allowance will simply reflect the added cost per mile.

Assuming that the third possibility is representative of what will actually occur, then we are left with the perplexing problem of explaining the mammoth increases projected by the Treasury for fiscal year 1983, a rate which is double the projected increases for each of the remaining outyears. Since even nonitemizers are now permitted to claim a deduction for charitable mileage, the increase cannot be attributed solely to an increase in the number of people claiming exemptions unless there is a corresponding increase in the number of miles driven on behalf of charitable activities, which, in turn, will further decrease the demand for federal revenues.

Another argument that has been advanced in opposition to the increase in the volunteer mileage deduction is that "of the difficulty in identifying and quantifying the amount of indirect costs in operating privately owned vehicles for charitable purposes that are properly attributable to the charitable endeavors." The problem with this argument, as we see it, is that it assumes a difficulty that would not, in fact, be present since the volunteer mileage rate deduction would be tied to the business/Federal employees' mileage deduction rate. Indeed, 1167 and S. 1579 will simplify the regulatory burden of the Treasury Department because there will be one rate and one formula to determine that rate.

Moreover, arguments which argue current law, as opposed to arguments which examine the merits of the proposed change, are not really arguments but rather statements in support of the maintenance of the status quo. Mr. Chairman, let's look for a moment at the maintenance of the status quo. In 1957, the year prior to the institution of the volunteer mileage tax deduction, the average cost of a gallon of gasoline in the United States was 30.9¢ a gallon, and the allowable tax deduction was $0.07 per mile. During 1983, the average cost of a gallon of gasoline has been $1.27 and the allowable tax deduction $0.09 per mile.

Looking at these figures in another way, we see that during the last 25 years the allowable tax deduction for charitable privately owned vehicle use has increased by 28.6 percent, while during the same period, motor fuel has increased by 310 percent. Likewise, in 1957, the allowable deduction represented 22.7 percent of the cost of a gallon of gasoline, but by 1983, the allowable deduction represented only 7 percent of the cost of a gallon of gasoline. For today's driver to maintain parity with the volunteer driver of 1958, in terms of percentage of cost, he would have to be allowed a deduction of $0.28 a mile.

Mr. Chairman, the volunteer community is not asking that the volunteer mileage deduction be raised to $0.28 a mile. Instead, the volunteer community is only asking for a parity with persons who, today, use their automobiles for Government and commercial purposes. We believe that this is not only a fair request, but a responsible request as well.

Mr. Chairman, it came to my attention this weekend that the Small Business Administration reimburses its volunteers in the Service Corps of Retired Executives, SCORE, with 20.5 cents a mile. I would be happy to respond to any questions that you might have.

Senator ARMSTRONG. Thank you very much. We will be back to you in a moment. Mr. Chromy, am I saying your name correctly?

Mr. CHROMY. Yes, sir.

Senator ARMSTRONG. Mr. John Chromy, you are here to represent the board of directors of VOLUNTEER. We are very happy to have you with us.

STATEMENT OF JOHN CHROMY, MEMBER, BOARD OF DIRECTORS, VOLUNTEER: THE NATIONAL CENTER FOR CITIZEN INVOLVEMENT, WASHINGTON, D.C.

Mr. CHROMY. Thank you, Senator. As I sit here, it is amusing to myself that I am delighted to be here to testify in support of these two bills for three reasons. First of all, it is kind of a personal one. I have been a volunteer all of my life. And when I heard I was going to testify on behalf of this, I put in a telephone call to my brother and my nephew, both of whom are small town boys in Minnesota, who work and earn salaries ranging about $11,000 to $13,000 a year, and both of whom serve as emergency medical technicians and run along with 16 other men and women in that community the town's only ambulance service. And I asked them if it would make a difference to them and their colleagues if they were able to get an additional 10 or 15 cents a mile deduction for all the mileage that they put in every time that beeper goes off, and they run out of church or leave their work at the grocery store or their job as a stock clerk in the Minnesota valley engineering program, and run off to grab that ambulance and get out there and help people who have had accidents and so on. Both my brother and my nephew said, "My God, John, that can only help. And I would be delighted if there was some way that that kind of thing could be arranged." I mention that only because I think my brother and my nephew are one of tens of hundreds of thousands of men and women in the communities across the country who do just this kind of thing.

I am also delighted because I was out of town during 2 weeks in July down at Baton Rouge, La., where the program that I work for, the special Olympics, was conducting its international special Olympics games. I was delighted to come back to Washington and find out—because when you come back to Washington you seldom expect to hear good news in July and August—the good news that you had scheduled this hearing, and that you were going to speak up for—at least let people speak up for—the 92 million people who volunteer in this country. That was good news and a delight for me to have. The third reason I am delighted to be here is because I consider it a real privilege and an honor to be at the same table with people representing two of our Nation's largest and certainly the most super volunteer organizations who have done so much for the country, both the Association of Junior Leagues and the American Legion. I know we could not run special Olympics without the volunteer help from both of those organizations. In special Olympics this past year, we calculated that probably we had 137 million hours of volunteer time to help a million mentally retarded athletes have a chance to train and compete in sports. That is the kind of thing we are supporting and trying to protect with this bill.

Senator ARMSTRONG. How many hours did you say?

Mr. CHROMY. 137 million in the last year.

Senator ARMSTRONG. I didn't mean to interrupt. I wanted to be sure I had heard that correctly.

Mr. Chromy. Yes, sir. That is our calculations. That is what it takes to have a million mentally retarded athletes trained, be coached, practice, compete in sports throughout the year instead of be sitting in State institutions or being hidden at homes in closets because people are ashamed to have them in public. That is just one small program compared to everything that is going on at the Legion and the Junior League and others are doing.

So that is my introduction. I am here on behalf of the board of Volunteer, an organization that constantly tries to encourage and assist volunteer movements in the country. I bring you, Senator, greetings from Gov. George Romney, our chairman of the board, a man who you know has committed his life to volunteer service, in addition to his public service and his personal service. Since 1972 when he left his Cabinet post, he formed the National Center for Voluntary Action, which our current agency is a descendant, and he has been fostering volunteer spirit in this country ever since that time. He regrets he cannot be here. He sent me as kind of a third string substitute and I will do the best I can.

We, too, have written testimony which I will submit for the record. I will just highlight the key points, and I will do my best not to repeat the things they said because they said them very well.

We, of course, support your bill and the bill of Senator Durenberger to raise the volunteer mileage to make it equal to that provided either to private business deductions or to government employees who use their privately owned vehicles for volunteer mileage. We support it because we think it is important to continuing to have the kind of volunteer service that has been identified here this morning. It is important to avoid knocking people out of volunteer service because they no longer can afford the expense. We have some indication that that is starting to happen. We have talked to some of the leaders of the retired senior volunteer program, which has some 300,000 volunteers across the country. They find that some of their volunteers are starting to back out because they can no longer afford the transportation costs that are involved. We would particularly hate to see that with senior citizens who are giving of their time because they most often are on fixed incomes.

The people here have already talked about the size of the volunteer community. We know its 92 million people. It is not only that I think—it is that number of people—I think it is the thing that they do that really is important here. Our country was founded on volunteer service. It was built by volunteers. They opened the lands; they built the towns; they built the communities; they did the traditional barn raisers. They still do them out where I grew up and come from and where my family still is in Minnesota. I am sure they still do them in small communities in Colorado. Not only that, they man the firetrucks, and they man those ambulance in many of those communities. I live in Prince Georges County, Md., which is a relatively large community. We have some professional firemen, but we have a lot of volunteer firemen. When that whistle blows in Prince Georges County, people still leave their jobs, jump in their cars and drive to the source of that tragedy and go to work to help make it happen. Those are the kinds of people we are continuing to support. They raise the funds to fight cancer. They combat birth defects, and they raise the funds to battle heart disease. Those funds that they raise multiply that that the government appropriates for those kinds of things. The volunteers we are talking about are the ones who filled the sandbags when there are floods; they are the ones who come to the fires and other disasters; they work in support of the local churches, the arts programs that were mentioned. Volunteers give in excess of 11 billion hours of service each year in this country, service which has been valued by the Gallop Poll of 1981 and in the independent sector as a minimum of $40 billion worth if we had to pay the minimum wage to have all these people do these services: $40 billion. If you calculate in any sort of increased level for the various professional services involved, it would be roughly $64 billion as a best estimate of what that is worth if our society had to pay for those services. By comparison to that kind of money, the $100 million deficit in revenue that our Treasury colleagues envision I think is pretty small. We would like to emphasize the other because I think we want to keep that growing. I think the administration does, and certainly those who are committed to the American tradition of a free society and a society that takes care of its own and meets its needs wants to see that kind of thing continue.

I think there are two other significant factors that I would like to enter in the record that haven't already been mentioned. As someone who administers a volunteer program and having talked over the years to administrators of volunteer programs all across the country, probably the single most difficult volunteer service to arrange and keep going and consistently make available is that of transportation: getting the people who can drive the kids to the programs; getting the people who will pick up those senior citizens and take them to their medical treatments; get those meals out to the folks who are locked at home; finding volunteer drivers who have access to vehicles and keeping them going and keeping them available is probably consistently the most difficult volunteer assignment to fill. I think my colleagues would agree with that. Part of it is it just costs one whole chunk of money to have a car and to continue to provide that service. As they indicated, the cost of gasoline and everything else, as you rightly indicated to our friend from the Treasury, that 9 cents a mile no way does it come near what it costs you to run that vehicle unless you are driving some sort of a little motor scooter, and then you can't take very many people to the hospital. It is clear that if I am a pharmaceutical salesman and I am in a private business, and I am driving to the hospital to sell my product, I can depreciate 20 cents a mile for my work to go and sell those products. On the other hand, if my neighbor wants to take a sick person to his kidney dialysis at the same hospital, the most he can deduct is 9 cents a mile. As you rightly pointed out, given his tax bracket, we are coming down to 3 cents a mile. Those are very, very serious discrepancies.

Our country wants these people to continue to provide these services. We recognize that without these services our society, as we know it, could not continue to exist. Most of the good of American society would fall by the wayside if we did not have people providing these services. I think we need to make it happen.

The other important factor, along with the difficulty of finding people to do this transportation, is that if our organization or the Cancer Society or anyone else had to reimburse people at 20 cents a mile for the miles that they put on—and this happens. When you administer a program, a volunteer comes in and says, you know, Mr. Chromy, "I like doing this, but I just cannot afford to do it so often. I am only going to be able to do it once in 2 weeks or once a month instead of every week because I just cannot come up with the funds any more." What happens, as an administrator, you start to say, "Well, let me see if we can shake out some of the money and reimburse you for more of the mileage," and so on. What that means, of course, is the Cancer Society or the Heart Association or the rest of us have to then raise more money, more cash contributions, to pay the 20 cents a mile. So it becomes a double burden. Not only can't you find people, but you can't pay for it.

With that, Senator, I would like for you to know that our organization strongly supports your efforts on behalf of the volunteers. We hope that you will do everything you can to pass it, and we will do everything we can to help make it possible. Yes, the revenue issue is a serious one—and we know the deficit problem is a serious one—I think our organization, Volunteer, and I assume some of our colleagues as well, would be willing to work with you on the passing of legislation that would establish the principal of equity and provide even 1-, 2-, 3-year periods to build up to the equity amount. But it is important that we say to the volunteers and the public we believe in it. It is as important as our private sector. It is as important as the service that government employees provide. And we are committed to raising that allowance up to and equal to those folks. If we do this it will encourage our volunteers to continue this important service. And in addition, it will provide recognition of the special contributions of America's volunteers. It will show that the President, the Congress, and all of our society cares about the work of these special people, and it will show that this legislation like to service our volunteers. Senator, it is not only needed and important but it is right and it is just. Thank you very much.

Senator ARMSTRONG. Thank you, Mr. Chromy.

[The prepared statement of John Chromy follows:]

Testimony in support of
S. 1167 and S. 1579
Volunteer Mileage Equity Legislation

by

John Chromy

member of the Board of Directors

VOLUNTEER: The National Center for Citizen Involvement

Thank you, Mr. Chairman and members of the subcommittee, for this opportunity to testify on the very important topic of mileage equity for volunteer drivers. I am John Chromy, a volunteer myself, and a member of the board of directors of VOLUNTEER: The National Center for Citizen Involvement.

VOLUNTEER is the only national voluntary organization that exists for the sole purpose of encouraging the more effective involvement of all citizens in community problem-solving. We serve as a national advocate for volunteering and work to improve the effectiveness of volunteer management skills by providing a variety of information-sharing, training and technical assistance services to local, community-based volunteer groups.

VOLUNTEER maintains a close working relationship with the over 300 local Volunteer Centers and Volunteer Clearinghouses that place more than 250,000 new volunteers in community agencies each year. We serve an additional 6,000 local, state and national organizations through our Associates program and our magazine and we provide training and information services to over 10,000 volunteer leaders annually.

I am here today, Mr. Chairman, on behalf of our chairman, Governor George Romney, who sends his regrets at not being with you as you address this important issue. Governor Romney feels very strongly about the unique contributions of volunteers in our society and about the need to provide those volunteers with continuing incentives, as well as with the recognition they so rightly deserve.

On behalf of Governor Romney, the entire board of VOLUNTEER and 92 million American volunteers, I strongly urge the passage of legislation to equalize the tax deductions for volunteer drivers. This legislation would relieve a portion of an increasing financial burden which is being shouldered by volunteer drivers and would provide a visible means for our government, the Congress and our society to recognize the enormous contributions of the volunteers who so willingly serve this country.

The volunteer community -- those individuals who give their time and energy to help meet our country's needs -- is broad and far-reaching. A 1981 Gallup survey highlighted the amazing fact that over half of the adults and half of the teenagers in this country are volunteers. These volunteers are from every social, economic, ethnic, age, cultural and religious group in our country. There are 92 million American volunteers. They work in hospitals, libraries, day care centers, nursing homes and neighborhood organizations. They serve on boards of directors and on community councils. They staff our fire departments and our ambulance services. They council troubled youth, work with 4H-ers and train young athletes.

They raise the funds that fight cancer, combat birth defects and battle heart disease. They are always there to stack the sandbags, staff the shelters and rescue the stranded during floods, fires and other disasters. They work with their local churches and support the arts in their communities. They fight for the rights of others. They feed the elderly, help the disabled and transport the injured. They supply needed services and work for the benefit of others and the communities in which they live. Volunteers give in excess of 11 billion hours of service each year, service which has been valued at a record-high of $64.5 billion annually.

Hundreds of thousands of miles are driven each year by these volunteers. Although there are no national surveys on the use of personal automobiles for volunteer work, local statistics speak for themselves. A study coordinated by the Volunteer Bureau in Montgomery County, Maryland estimated that volunteers had driven over 800,000 miles in one year. In Minnesota, a Board on Aging survey of transportation programs for seniors revealed that over three million miles were driven by their volunteers in that great state.

The Maryland Lung Association estimates that their board of directors alone drive over 36,000 miles each year to support a program which does so much to fight lung diseases. In Dallas, Texas, volunteer Big Brothers and Big Sisters drove in excess of 250,000 miles in 1982 to support troubled boys and girls in that city. The American Red Cross has estimated that individual Red Cross volunteers across the country are driving from between 2,000 and 12,000 miles each year while providing the assistance that our medical services, our disaster services and, indeed, our military services could not do without.

The director of the District of Columbia Retired Senior Volunteer Program, a part of a national network of over 300,000 volunteers, recently told us that many of their volunteers are unable to continue volunteering as a result of the high costs of driving their cars. This problem is further complicated since many senior volunteers share rides to volunteer assignments. Many other volunteers feel similar economic strains. Fortunately, many of them just dig deeper into their pockets and continue their service, but many volunteers may not be able to continue.

The value of volunteer time cannot be expressed in figures and statistics alone. Why do Americans volunteer? They volunteer partly because it's an American tradition. Indeed, it is the way in which our country was founded, developed and built into the great nation it is today. Americans also volunteer because they are a fundamentally generous, helpful and caring people. They also volunteer because they have been asked, because they are needed and because they know that others care about what they do. But, most of all, they volunteer because they know that it is right to do so!!

Stop for a moment, Mr. Chairman, and consider where our nation would be without its volunteers -- the elderly shut-in waiting for a hot meal that would never come, the scout troops that would never take another camping trip, the child with leukemia who would never get to her cancer treatment center, or the accident victim who might never receive his emergency medical treatment. Our world would be much a much different place than it is now, Mr. Chairman. In fact, if volunteers ever stopped caring and giving, American life as we know it would cease to exist.

Sydney Harris, the syndicated columnist for the Chicago Sun Times described the contributions of the American volunteer when he participated in the 1981 National Forum on Volunteerism. He said, "one of the sectors has money, one has power and we have people.... The money and the power can't do much without the people...."

We have recognized that the contributions made by our nation's volunteers are invaluable, Mr. Chairman. We have gladly accepted the hours of service they have given and acknowledged the many miles they have driven in providing those services. And, yet, the federal government has choosen to place a lower value on those contributions than they do on those made by the paid worker. While the paid government social worker is allowed to claim 20¢ per mile for driving to a hospital to visit a sick patient, a volunteer is only allowed to deduct 9¢ per mile for making that same visit. The medical supply salesman who uses his car in the course of his work is allowed to deduct 20¢ per mile, but his neighbor will only be allowed to deduct 9¢ per mile for transporting cancer patients to and from their treatment centers.

The Treasury Department has estimated a revenue loss of $100 million if this legislation were to pass. Compare this figure with the enormous value of the contributions of our nation's volunteers. Do these contributions mean less to our country than those of its paid workers? The symbolic implication of this inequity is hard to explain to the 92 million Americans who give their time and energy for others and for their communities. In addition, let me remind you that the current dollar value of volunteer activity in this country is $64.5 billion. I think you will agree, Mr. Chairman, that these facts, when combined with the potential for increased volunteer activity, make the revenue loss seem relatively small indeed.

The United States government has a long-standing tradition of encouraging charitable giving through its tax laws. The enactment of the recent charitable contributions legislation has made current deductions available to all taxpayers. As a result, passage of volunteer mileage equity legislation is now even more important since it affects volunteers at every economic level. We would stress, Mr. Chairman, that government leaders have increasingly turned to the volunteer community to provide needed services. It is a contradiction that this same government does not encourage and support these activities with its tax laws.

The American Automobile Association has released recent figures that estimate the cost of operating an automobile at 23.8¢ per mile. Although lower than in previous years, we would emphasize that this cost is nearly 4¢ per mile more than the current rates allowed to business and government drivers and 15¢ per mile higher than the current rates allowed volunteer drivers.

There is no justification for this inequitable treatment. Volunteers play a unique role in our country. Their contributions can be measured in dollars and in the economic, social and ideological well-being of our society. VOLUNTEER commends the efforts of Senators Armstrong and Durenberger and of Congresswoman Mikulski to equalize the mileage tax deduction allowed volunteers. This is a necessary step to ensure equity toward the value of the work performed by all our citizens. It will encourage our voluteers to continue the very important service they perform. And, in addition, it will provide recognition for the special contributions of America's volunteers. It will show that the President, the Congress and all of American society also cares about the work of these special people. This legislation, like the service of our volunteers, is not only needed and important, it is right and just! Thank you.

Senator **Armstrong**. Miss Crawford, thank you for your testimony this morning and, more than that, for what the Junior League is doing. I am very familiar with some of the good work that the Junior League has done and we are grateful to you for that. I was especially glad that you mentioned the contribution to this effort that my friend Eunice Fine of Greeley, Colo. made. I didn't know that was in your testimony until I read it, but that is great.

I want to ask one question, and then in some version or another I may ask each of the witnesses that question. Our time is limited, but I would be interested to have you comment briefly on the question of whether or not this is an abstraction and we are really just sort of shoveling smoke here, or whether or not it is a serious problem to people who would otherwise be more willing to take part in volunteer activity? Obviously, volunteers are making a tremendous contribution to the life of the country. But is it a real hardship for them or is it mostly an abstraction or a status symbol or something of that kind? What do you find among the people you are in contact with?

Ms. **Crawford**. I think there is no question that it is a problem, that there are programs that truly are in jeopardy because it is difficult to recruit and keep volunteers or to keep volunteers on the same regular schedule that they have had before. Volunteers are rich and poor. Volunteers cannot all afford unlimited out-of-pocket expenses, and there are often other expenses related to volunteer work in addition to the cost of transportation, such as child care, and telephone costs, meals away from home, whatever. So volunteering isn't free. It is very important that volunteerism doesn't become a luxury in our country. It has been, as pointed out, part of our country from the very beginning. Those programs are valuable in all of our communities, and I think many of them would be in jeopardy if they start losing volunteers, and eventually could be a financial burden on the public sector to replace those services.

Senator **Armstrong**. Aside from this legislation and the specific problem that it is addressed to, do you sense that, in general, there is a greater willingness on the part of Americans today to serve in volunteer activities a declining willingness or about the same? In other words, well, let me be more specific. Sometimes people tell me that we are just not as willing to undertake barn-raising kinds of activities. I have forgotten who used that expression, but back in the frontier days when we were all very close together, when we were all neighbors, and we all knew when somebody had a problem and we would pitch in and help, and that today we are more isolated, and our communities are more impersonal, and there is less willingness to do that. How do you find that? Are people still willing to participate? Is it going up, down, staying the same, or what do you think?

Ms. **Crawford**. I would think people are very definitely still willing to participate. It may be that some of the ways they can participate in terms of time, they may need to do volunteer activities in the evenings or on weekends or from their homes, as more women are now employed, as it is more expensive. But I think very definitely that the spirit of volunteerism is very strong in this country.

Senator ARMSTRONG. I thank you. I hope you are right. I believe that you are. But as I said earlier, it appears to me that the contribution made by volunteers cannot be adequately measured in money; that the spirit that they contribute to the life of communities and to our national life far exceeds even the large dollar value of it.

Mr. Miller, I was glad that you included in your statement some of the specific activities that the American Legion takes part in, and has shown great leadership, too. I was glad that you included in your statement at page 4 your disputation about the estimates by the Treasury Department, which I also have some reservations about. And I was especially glad that you included in your closing arguments about the essential fairness question, which, in my view, is probably the most important reason why we ought to enact this legislation, even more than its literal effect on the financial status of volunteers. I thank you for doing that. Let me ask this question. Do you find that members of the American Legion—and I am really putting the same question that I put to Miss Crawford—do you find that members of the American Legion are affected in a serious practical way or is this mostly an abstraction with them? Are there people who you know in the American Legion membership who would be more willing to actually go out and perform volunteer activities in the community if they could overcome some of the costs of transportation?

Mr. MILLER. Oh, I don't think there is any doubt about that, Senator. I think what we need to do is look at the current volunteer mileage deduction for a second in terms of its reality. The Treasury made a statement that people can deduct their actual cost of gas and oil if that is more favorable. What Treasury failed to mention was that option is only available to people who itemize. A great many volunteers on fixed income—retirees—no longer itemize deductions. For them to go into that whole procedure would be, again, costly. Currently, volunteers are allowed to take 9 cents a mile, but there are some limitations on that. One, the maximum tax deduction that a non-itemizing volunteer can take is only $100. Of that amount they can take one-quarter this year. Next year, I believe, it is going to be 50 percent. That means if a volunteer only drove 1,200 miles, their volunteer mileage alone would total their full allocation of charitable contributions, according to the IRS. Now if they are only allowed to take 25 percent, that means they are spending $100 for gasoline but being reimbursed $25, or actually achieving a reimbursement of $25 on the $100. So they are actually sustaining a financial liability to volunteer. I think that that cannot help but affect the amount of miles driven, the kinds of uses to which a vehicle will be put. In the letters that we received, one woman, to give you an example, put in 597¾ hours of volunteer work driving 4,924 miles. This woman happens to be, as I understand it, in her 50's. This woman is concerned because she can no longer afford to drive that many miles. In fact, her auxiliary unit offered to give her $5 to help defray her costs, and she said no, because the auxiliary unit could use that $5 for another program.

Senator ARMSTRONG. I appreciate you personalizing it in that way.

I say I appreciate your personalizing it in that way. That is very useful. So many of my colleagues—and it is a natural thing—tend to look at overall trends, and look at an issue such as this as if they were statistical phenomena rather than real life circumstances.

Mr. Chromy, I especially appreciated your sharing the observations about your family in Minnesota, and how they would react and how they would be affected. That was very useful. I really don't have any questions to ask. Your statement was excellent. We would like to put the whole statement in the record. Your observations were very good and we appreciate your sharing them with us.

Mr. **Chromy**. Could I share on that last question that you did ask: does it really affect people? I watched it affect, in special Olympics, for example, when we asked parents to volunteer to drive a group of mentally retarded athletes to a Saturday competition 40 miles away, and they are thinking in terms of their Chevrolet, and 40 miles back and forth is almost a half a tank of gas. And if you recall when you pull into a gasoline station what a half a tank of gas costs nowadays. That is a $10 bill, or close to that, going out of your pocket. You can just see people trying to wince when they have to think in terms of that extra half a tank of gas and that $10 bill, that it really does make a difference to people. They still put it out, and they still do a lot of it. But it is hurting and I think it is an important issue, sir.

Senator **Armstrong**. Thank you very much. Thank you all.

There will now be a brief period for the changing of the guard. [Pause.]

Senator **Grassley**. We now want to proceed to consideration of S. 108. I am the originator of S. 108, and I have a statement that I am going to put in the record rather than reading it at this time, in explanation of my legislation and support of it.

Our next list of witnesses as Congressman Ron Wyden, from the State of Oregon; Gary Conkling, director of government relations, Tektronics, in Beaverton, Oregon; Wayne Newton, trustee for Kirkwood Community College, Cedar Rapids, Iowa, and a constituent of mine, I might point out; and Dr. Richard Greenfield, chancellor of St. Louis Community College, St. Louis, Mo., and ask you all to come. I would like you testify in that order. Congressman Wyden, if you are in a hurry and you have to leave before the panel is done, would you please tell me as I have one or two questions that I want to ask you.

Representative **Wyden**. That would be most helpful, Senator.

Senator **Grassley**. All right. Then we will proceed with you and I will have a dialogue with you before we go on to the remaining members of the panel. Would you proceed?

STATEMENT OF HON. RON WYDEN, A U.S. REPRESENTATIVE FROM THE STATE OF OREGON

Representative **Wyden**. Senator, thank you very much. It is a great pleasure to be here and testify in support of your legislation, S. 108. It is also a pleasure to be seated on the panel with Mr. Gary Conkling of the Tektronics Corp., a gentleman of considerable talents. Tektronics, our largest employer in the State of Oregon, has done a tremendous amount to promote educational reform. I have to admit not being unbiased with respect to Mr. Conkling. He is my former administrative assistant. My loss is Oregon's gain, and I am very happy to be here with him.

Senator, I wholeheartedly support this legislation. I am convinced that by enacting this bill, Congress will take a major step toward making available to our young people the training that they are going to need for tomorrow's jobs. For the last several months, as a member of the House bipartisan task force studying the concept of merit pay, I have been deeply involved in the issues of educational reform. At hearings that were held in Washington, D.C., as well as one that I just held in Oregon, one witness after another said that any effort to reform education in this country simply must address the prospect and the need to beef up vocational education in the United States. That is why I am very glad to be able to support this legislation that helps answer some of the concerns that I have heard witness after witness raise around this country. In particular, we have got to look at new ways to figure out how vocational schools and community colleges can get the instructors and the equipment that is needed to train workers for the changing job marketplace.

I think it is pretty clear that tomorrow's jobs are going to require expertise in technical knowledge. The Task Force on Education for Economic Growth wrote in its June 1983 report: "Jobs which offer upward mobililty will increasingly be those which require the use of technology."

To meet this challenge, we need vocational training programs that are as modern as the job market. That means schools with new textbooks, skilled teachers and state-of-the-art equipment. Tight budgets everywhere, especially in education, mean that we need to develop a new, mutually beneficial partnership between the parties directly affected: business, government, schools, and parents. I think that S. 108 offers an opportunity for the Federal Government to promote that kind of partnership. S. 108 achieves this by recognizing the great importance of how our community colleges train workers. With more than 1,200 of those colleges across the Nation, they are in the position to train students in a short period of time in a particular vocation, and to work with local businesses to provide employer-specific courses. Their track record is impressive: Community colleges train more than 11 million workers every year. But I think there is room for improvement. To maximize the potential for training students for the advancing job market, our nation's community colleges need to have the correct tools: state-of-the-art tools such as electronic engineering technology, computer software, and new medical equipment. They also have to have the teachers who know how to use this equipment and who know about current developments in these areas.

I think your bill, Senator, gets right to the root of the problem. It will provide tax incentives to industries which donate equipment for vocational education programs, as well as tax credits to companies which allow employees to teach vocational programs without compensation or which employ temporary full-time vocational education instructors.

In my own home State of Oregon, as in many States, the budget for higher education has been increasingly hard-pressed. Appropriations for higher education have fallen 3 percent in the last 10 years as our State legislature, like so many, has looked for ways to hold down spending. At the same time, Oregonians have been—and are—reluctant to pay additional taxes, leaving school levies in Oregon with very, very tough prospects for approval.

With money short, one of the first things to be cut from a college or vocational school's budget are the funds to purchase expensive equipment. I think we all realize that computers aren't cheap.

Your legislation would help cover some of the expense of modernizing that equipment with a very modest cost to the Federal Government. It would also provide incentive for industry to donate personnel to help teach student about new technologies so they will be ready to come out of training and take up a job quickly, thus furthering our competitive standing in the international marketplace.

Again, in Oregon, Senator, the economy is just beginning to recover from 3 years of serious recession. Unfortunately, most of the equipment in our community colleges is 5 to 10 years behind the times, seriously outdated, and the need for new equipment has been simply too great for either the colleges or the businesses to meet. I think it is a need we have got to meet. We must train more students to work in high technology fields. To do that, the people and the tools have to be made available to vocational schools.

I have often said that to keep pace with our foreign competitors, we must have an educational system which is committed to keeping our human capital as rigorous as our investment capital. S. 108 would help us to achieve that goal. I very much urge your support and congratulate you for all the leadership that you have brought to this issue, Senator.

Senator **Grassley**. Well thank you very much. I appreciate your testimony. I think you have answered my first question because it was in regard to whether or not you felt that the bill provided an appropriate Federal role in meeting the equipment and staff to develop a means for our community colleges by encouraging greater private sector investments. I think your enthusiastic support of your testimony indicates that. Did I interpret it right?

Representative **Wyden**. Absolutely. And I think what your legislation does, Senator, is carve out a modest and yet still very meaningful role for the Federal Government to play in promoting vocational education. I think you and I would both concur that with a $200 billion deficit staring us in the face we cannot go out and start enormous, new programs and just spend money indiscriminately. What your bill does is it gives us a chance to target a specific problem, a very real problem, in my State and throughout the country. And for that reason I think it does carve out a modest and yet still very meaningful role for the Federal Government.

Senator **Grassley**. Yes. Could I ask your view—it is somewhat related to the bill, but not totally related to it—whether or not you see a need for more Federal support for technician training programs as opposed to professional engineering and science programs?

Representative **Wyden**. I think we ought to proceed vigorously in both those areas. I think that the technological revolution is going to produce job opportunities in both of those areas. I would just suggest that at this point we move vigorously in both of them and not try now to sort out one at the expense of the other.

Senator **Grassley**. All right. Thank you very much. And I appreciate the fact that, the House being in session, that you have to leave. And I thank you for your contribution.

Representative **Wyden**. I very much appreciate your graciousness, Senator. Thank you.

[The prepared statement of Congressman Ron Wyden follows:]

TESTIMONY
OF
CONGRESSMAN RON WYDEN

AUGUST 1, 1983

Thank you, Mr. Chairman, for the opportunity to speak before this subcommittee in support of Senator Grassley's bill, S. 108.

I wholeheartedly support this legislation. I'm convinced that by enacting this bill, Congress will take a major step towards making available to our young people the training they need for tomorrow's jobs.

For the last several months, as a member of the House bi-partisan task force on merit pay, I have been deeply involved in the issues of educational reform. The issue of vocational education has come up again and again.

That is why I am glad to be able to lend my support to a bill that helps answer some of the concerns we have discussed -- principally, how vocational schools and community colleges can get the instructors and equipment needed to train workers for the changing job marketplace.

It is clear that tomorrow's jobs will require technical knowledge. As the Task Force on Education for Economic Growth wrote in its June 1983 report: "Jobs which offer upward mobility will increasingly be those which require the use of technology."

To meet this challenge, we need vocational training programs as modern as the job market. That means schools with new textbooks, skilled teachers and state-of-the-art equipment.

Tight budgets everywhere, especially in education, mean that we must develop a mutually beneficial partnership between the parties involved -- business, government, schools and parents. S. 108 offers an opportunity for the federal government to promote such a partnership.

The bill achieves this end by recognizing the great importance of our community colleges in training workers. With more than 1200 of these colleges across the nation, they are in the position to train students in a short period of time in a particular vocation, and to work with local businesses to provide employer-specific courses. Their track record is impressive: Community colleges train more than 11 million workers each year.

But there is room for improvement. To maximize their potential for training students for the advancing job market, our nation's community colleges must have the correct tools -- state-of-the-art tools such as electronic engineering technology, computer software and new medical equipment. They must also have teachers who know how to use this equipment and who know about current developments in these areas.

Senator Grassley's bill gets to the root of the problem: It would provide tax incentives to industries which donate equipment for vocational education programs, as well as tax credits to companies which allow employees to teach vocational programs without compensation or which employ temporary full-time vocational education instructors.

In my home state of Oregon, as in many states, the budget for higher education has been increasingly hard-pressed. Appropriations for higher education have fallen 3 percent in the last 10 years as the state legislature has looked for ways to hold down spending. At the same time, Oregonians have been -- and are -- reluctant to pay additional taxes -- leaving school levies in Oregon with dim prospects of approval.

With money short, one of the first things to be cut from a college or vocational school's budget are funds to purchase expensive equipment. And we all know, computers aren't cheap.

Senator Grassley's legislation would help cover some of the expense of modernizing equipment -- with little cost to the federal government. It would also provide incentives for industry to "donate" personnel to help teach students about new technologies so they'll be ready to come out of training and take up a job quickly -- thus furthering our competitive standing in the international marketplace.

In my state, the economy is just beginning to recover from three years of severe recession. Unfortunately, most of the equipment in our community colleges is 5-10 years behind the times. The need for new equipment has been simply far too great for either the colleges or the businesses to meet.

Yet, it is a need we must meet. We must train more students to work in high technology fields. To do that, the people and the tools have to be made available to vocational schools.

I have often said that to keep pace with our foreign competitors, we must have an educational system which is committed to keeping our "human capital" as rigorous as our investment capital. S. 108 would help us to achieve that goal. I urge its favorable adoption by this subcommittee.

Thank you very much.

Senator **Grassley**. Thank you. Mr. Conkling.

STATEMENT OF GARY CONKLING, MANAGER OF GOVERNMENT RELATIONS, TEKTRONIX, INC., BEAVERTON, OREG., ON BEHALF OF THE OREGON COMMUNITY COLLEGE ASSOCIATION

Mr. **Conkling**. Thank you, Mr. Chairman. My name is Gary Conkling, and I am manager of government relations for Tektronix, Inc., in Oregon, and I am appearing here today on behalf of the Oregon Community College Association. I would ask your permission for my written statement to appear in its entirety in the record. It is the statement of the Oregon Community College Association. If I could be allowed, I would like to make a few oral remarks on behalf of my own company today.

Senator **Grassley**. Yes. The statement will be included in the record as a matter of practice, but specifically for yours. And then would you proceed?

Mr. **Conkling**. Yes. Thank you.

[The prepared statement of Gary Conkling follows:]

TESTIMONY

on

S.108

by

Gary Conkling
Manager of Governmental Relations
Tektronix
Beaverton, Oregon

on behalf
of the
Oregon Community College Association

Subcommittee on Taxation and Debt Management
Senate Finance Committee
U.S. SENATE
August 1, 1983

OCCA
OREGON COMMUNITY COLLEGE
ASSOCIATION

Chairperson Packwood and members of the Subcommittee, my name is Gary Conkling, Manager of Governmental Relations with Tektronix, and I am here today on behalf of the Oregon Community College Association, located at 1201 Court St. NE, Salem, Oregon 97301.

I am here to speak in support of S.108. Passage of this legislation would help Oregon's community colleges and business and industry to respond to the job training and economic development needs of the state by:

- Extending to postsecondary occupational programs the same eligibility for equipment gifts from industry that the 1981 federal tax reforms allowed on equipment gifts to university research programs.
- Allowing companies that make their staff available to teach technical and occupational courses, a $100 tax credit for each course a company professional teaches---limited to five courses per year per individual professional.
- Providing a $100 tax credit for each off-term or part-time job that companies provide for a faculty member from an occupational program.

Community college occupational training in Oregon is, and will continue to be, highly dependent upon cooperative endeavors with business and industry. This bill would seek to further cement the partnership between the education community and business and industry.

Costly acquisition and updating of equipment are necessary if business and industry are to receive employable individuals trained on "state of the art" equipment. A May, 1983 survey of Oregon community colleges by the Oregon Department of Education identified an estimated immediate equipment need of over $5 million just to maintain current occupational/vocational programs at a minimum level and an additional estimated amount of $16 million to improve those programs to industry standard levels. Due to the tight budgetary picture Oregon is now facing, this need will continue to remain unmet...without the assistance of the private sector.

Oregon's community colleges have faced severe budget reductions during the last biennium and, at best, will hold the line on further reductions during the next biennium. Yet, the community colleges have attempted to assist in Oregon's economic recovery, to the extent possible, given budgetary realities. For example:

- Many have directed efforts to assist the unemployed workers.
    - More that 5,000 unemployed workers have attended "Moving Ahead" Workshops this year, designed to present options open to a person looking for work.
    - The colleges are working with their local Employment Division personnel to provide training opportunities for dislocated workers. Chemeketa Community College of Salem, Oregon is one of five colleges in the country

1201 Court Street N.E. • Salem, Oregon 97301 • (503) 399-9912

to receive a CETA demonstration project to train 82 dislocated workers.

- Small business management programs available through most of the colleges help individuals examine business opportunities, solve small business problems, market a product and keep accurate business records.

- Community colleges offer vocational education courses designed to train the support technicians...the foundation for high-tech development in Oregon. Programs have been established for:

  Tektronix
  General Telephone
  WANG Corporation
  Siltech Corporation
  Hewlett-Packard Corporation
  Wacker Chemical
  Georgia Pacific
  Boeing
  Intel Corporation

Furthermore, Oregon's community colleges anticipate increased demands during the next biennium to expand their role in economic development and provide training and retraining opportunities for dislocated workers through the new Job Training Partnership Act. This new program comes at a time when the colleges are projecting an enrollment increase of over 3,400 students in the next four years.

S. 108 will foster further the cooperative efforts outlined above and encourage the business community to become active partners with the community colleges in working toward the revitalization of Oregon's economy:

- Tektronix has recognized that community colleges are providing the important technical training that is critical to our industry. One of the principle reasons Tektronix has for donating equipment to the community colleges is to produce the high-skilled technicians that are necessary to keep Oregon competitive...especially with the expansion of the Pacific Rim market. Tektronix has endorsed the provisions of this legislation and urges its passage.

- According to Tom DePue, Personnel Manager with Siltec Corporation, located in Salem, Oregon, "Siltec works very closely with Chemeketa Community College: one of our employees is on loan to help with program instruction and we have either loaned or donated over $1/2 million in new equipment. Our company is relatively new and we anticipate a major growth in the next two years. This legislation would help us to expand our relationship with the college as we increase our productivity."

- Strong support also comes from Dr. Emil Sarpa, Corporate Manager for Academic Relations, Intel, Santa Clara, California. "Intel recognizes Portland Community College as the model for electronic training in Oregon because of their quality faculty and the orientation of their program to train workers to meet our needs. The tax incentives to business, provided in this legislation, will help to further promote the partnership we have established with Portland Community College and allow us to provide similar assistance to other community colleges in Oregon, California, Arizona and New Mexico."

S.108 will provide:

- A major incentive through the tax credits to business and industry.
- Assist community colleges in upgrading their equipment.
- Allow faculty to be kept current on state-of-art technologies in their field.

But, ultimately, the beneficiaries of this legislation would be the people: the newly dislocated worker, the disadvantaged unemployed, and workers who are in need of upgrading their skills to keep pace with new technological advances. I urge your support of this bill...it will help to further improve educational and training opportunities in Oregon.

Mr. CONKLING. High technology's ability to fulfill its promises as a creater of new markets and jobs, and as a partner with traditional industries, is predicated on the availability of highly skilled human resources; in our industry, specifically electrical and electronic engineers, computer engineers and the technicians that work with those engineers. An American Electronics Association report on technical employment projections for 1983 through 1987 indicates a need for 63.1 percent more electronic technicians, 65.5 percent more electrical and electronic engineers, 115 percent more computer, particularly software, engineers, 102.5 percent more computer analysts and programers, and 107 percent additional electronic engineering technologists. Despite what one reads about mechanization, there continues to be a healthy projected need of almost 64 percent for assemblers in our plants.

I think it says a lot, Senator, that today I am appearing here on behalf of both my own company, which is Oregon's largest private employer, as well as the Oregon Community College Association, which represents our extensive community college system in the State of Oregon. I think it tells you that the partnership between private industry and between community colleges exist today, and that both of us are committed to making it a better partnership in the future.

My company testified earlier this year before this same subcommittee in support of S. 1194 and S. 1195, which, as you know, would expand the use of the R&D tax credit for a number of purposes, and including the purposes included in your bill, S. 108.

We feel that the problems of the 4-year institutions, which are more broadly addressed in S. 1194 and S. 1195, apply to community colleges. There are too few qualified instructors and too much outdated laboratory equipment, but an abundance of interested students. There is also an abundance of possible jobs.

We feel that your bill, which we support wholeheartedly, goes a long ways toward meeting those needs. Specifically, it would extend to postsecondary occupational programs the same eligibility for equipment gifts from industry that the 1981 Federal tax reforms allowed on equipment gifts to university research programs. It also would allow companies that make their staff available to teach technical and occupational courses a $100 tax credit for each course a company professional teaches, limited to five courses per year for individual professionals. And, it will provide a $100 tax credit for each off-term or part-time job the companies provide for faculty members from an occupational program. In the interest of time I will stop here, but we hope you are successful in convincing your colleagues that S. 108 is a good bill.

Senator GRASSLEY. Wayne, I will go to you now and say that you follow in the tradition of the Kirkwood Community College trustees as being a strong and principled public servant. Since it was an institution founded back in 1966 or 1967, it always has been a magnet for people who are outstanding leaders in the community and are pacesetters. You continue in that tradition and your comments will be helpful to the subcommittee today. Would you proceed, please?

STATEMENT OF WAYNE NEWTON, TRUSTEE, KIRKWOOD COMMUNITY COLLEGE, CEDAR RAPIDS, IOWA

Mr. NEWTON. Thank you, Senator Grassley. I bring you greetings from our mutual friend, B. A. Jenson and Dr. Bill Stewart, from Kirkwood.

Once again, as we discussed in February, we very much appreciate your efforts in this legislation, Senate bill 108, and we also offer congratulations to your wife on the accomplishment of her degree recently.

Senator GRASSLEY. You watch television. And I thank you. I will tell her you said so.

Mr. NEWTON. We are extremely grateful for this opportunity to present these matters. And if my full written statement can be placed in the hearing record, I will try to paraphrase this as best I can.

I deeply appreciate the contributions that the two previous speakers gave us. I think it is interesting that we should have a Congressman and a member of the private sector support a somewhat public education bill, and I think that demonstrates exactly where we are at with the relationship and the cooperation that exists between the private sector and the public sector as it relates to education.

The largest phenomenon in postsecondary education in our country in the era since World War II, in terms of the numbers of learners being served, is the development and growth of community colleges. And you are well aware of that. It is not strange to the State of Iowa; it is growing by leaps and bounds. And I think without a doubt we will have a very large increase at Kirkwood as well as the other schools in Iowa. Just how vital the role and the potential of community colleges is to the national interest can perhaps be illustrated by three facts: First, well over half the citizens who now enroll in college for the first time are making their start in 2-year colleges. Many of these students are enrolled to earn advancement in the jobs they hold or because they need skills that will get them jobs to pay their bills so they can continue their education and improve the quality of their lives, something all of us had ought to work toward. Second, of the more than 5 million learners who enroll in credit courses and degree programs in the community colleges in the 1982-83 academic year, almost two-thirds have been taking occupational-technical courses. And, as you know, that is a very strong debate in the State of Iowa, that we remain occupational and technically oriented, which brings us to the third point: the community and technical colleges, in cooperation with local business and industry, have generated a tremendous number of what they commonly refer to as employer specific courses, programs that are tailored to meet a particular skill need or a set of related skill needs for a specific employer. The cooperative programing ranges all the way from basic communications skills to CAD-CAM programs and other high technological specialties. This brings us to the point of this hearing. The community colleges are very grateful to you, Senator Grassley, for authorship of S. 108, and the bill you originally introduced in the last Congress, which aptly reflects the national interest in what community colleges are striving to do to address the specific skill needs of industry, to help build the work force the country must have to stay ahead of global competition and to curb unemployment. The need for state-of-the-art equipment has become a serious hardship to community colleges in their ability to respond most effectively to the skill gaps that are plaguing American productivity. Wherever you turn among the States, the community colleges universally list state-of-the-art equipment for one or more technician courses at the top of the critical-needs list.

Very often, the courses most acutely handicapped by this need are those in the rapidly developing technologies, such as electronic and computer sciences, and robotics, where the American economy is hard pressed to meet global competition.

Senator, the speed of change is dizzying. Change is no quirk of this point in history; it will be a fact of our lives into the foreseeable future. To keep up with this change, to provide the opportunities to our work force to learn new skills or to upgrade their present ones, and to do it in state-of-the-art equipment, we must have the help of business and industry and the Congress needs to provide incentives to the private sector to give us the help.

Let me be more specific about our own State. In Iowa, our community college equipment shortages are plaguing such vital programs as data processing, computer repair, health technologies, electronics, industrial technologies, just to name a few, all of which are part of the growing curriculum response to the high technology demand.

These revolutionary changes are taking place in the office and in the factory as well. Laser beam technology in tool and die machinery, for example, is no longer the future, but clearly represents the present. And, of course, we are all well aware of the impact of robotics on the marketplace.

Our corporations expect us to train their future employees in a way that will easily adapt them to this technology. Instead, we, for the most part, are still using the standard equipment of the past several decades, equipment which is far removed from the state of the art.

At Kirkwood, for example—and I am sure you visited this program on your tour to the campus, Senator—in our machinist program, we still have some machinery which predates World War II. To replace this with just one or two laser beam machines would cost hundreds of thousands of dollars, something clearly beyond our grasp and that of our State's as well. Without proper equipment to train the work force, Iowa's unique and responsive system will surely begin to lag seriously behind. With States such as our struggling to avoid massive insolvency, and with the Federal Treasury empty, the only direction left to turn is to the private sector. Yet with the current state of the economy, they need some incentive to be able to respond as they desire. S. 108 establishes such an incentive.

Given the pressing state of productivity and employment in our country, and the urgency of the challenge to the American economy and American technology, the reasons for allowing tax incentives to firms that make state-of-the-art gifts to technical training programs in the community colleges, and other associate-degree granting institutions, are easily and strong and clearly as much in the national interest as providing such incentives for equipment given to university research. Both serve the ultimate need.

Regardless of the volume of talent the country might pour into science and engineering, our eminence in these fields and our leadership in emerging technology will never be secure unless it has the solid foundation of an adequate supply of advanced highly trained technicians.

Senator Grassley, thank you for the opportunity to share our ideas with you in this community today. I would be pleased to provide further information if you ask. The two organizations I am speaking for here—the Association of Community College Trustees, and the American Association of Community and Junior Colleges—strongly endorse S. 108 and urges its adoption. I would be happy to answer any questions that you might have.

Senator GRASSLEY. Let me give credit to the two organizations you mentioned for their efforts in assisting me in working out some of the details of the legislation, and also for helping us advertise its introduction around the country so we could gain the considerable support that we have.

Mr. NEWTON. Thank you.

Senator GRASSLEY. Dr. Greenfield, would you proceed, please?

[The prepared statement of Wayne Newton follows:]

Testimony

on

S. 108

Wayne Newton
Trustee
Kirkwood Community College
Second Vice President
Association of Community College Trustees
Member
Joint Commission on Federal Relations
Association of Community College Trustees
and
American Association of Community and Junior Colleges

on behalf of the
Association of Community College Trustees
and the
American Association of Community and Junior Colleges

Subcommittee on Taxation and Debt Management
U.S. SENATE
August 1, 1983

Mr. Chairman, the largest phenomenon in postsecondary education in our country in the era since World War II, in terms of the numbers of learners being served, is the development and growth of the community colleges. In the last decade, they have strongly, effectively emerged as the largest arm of American higher education. Today, they serve ten million or more learners -- perhaps as many as the rest of higher education combined -- and serve them across a tremendous range of modes and needs.

This growth has given them a role which will have a substantial bearing on the ability of our country to sustain its general prosperity and to meet the global challenges in technology and productivity. Just how vital the role and the potential of community colleges is to the national interest can perhaps be best illustrated by three facts:

First, well over half the citizens who now enroll in college for the first time are making their start in a two-year college. The community colleges now serve more than half the combined freshmen and sophomore enrollments of American higher education. This is not a population that Congress and the country can afford to ignore in our struggle to enlarge the professional ranks in science and engineering, and to turn out more and better teachers of math and science. Added to that is the fact that for every engineer we need four to five highly trained technicians in assisting positions.

Like the Congress, the universities and professional schools should realize that the demand for technician courses in the community colleges has grown by leaps and bounds, and continues to grow. Many students in these programs are getting intensive instruction in applied math and applied science. Many of these students are enrolled to earn advancement in the jobs they hold, or because they need skills that will get them jobs to pay the bills so they can continue their education and improve the quality of their lives. They may be technicians now, but many have the talents that could make them the scientists or engineers of tomorrow.

Second, of the more than five million learners who enrolled in the credit courses and the degree programs in the community colleges in the 1982-83 academic year, almost two-thirds have been taking occupational-technical courses. Outside American industry itself, the community colleges are the nation's largest trainer in the new technologies and other advanced skills.

Which brings us to the third point: The community and technical colleges, in cooperation with local business and industry, have generated a tremendous number of what they commonly refer to as "employer specific" courses, programs that are tailored to meet a particular skill need, or set of related skill needs, for a specific employer. These course offerings have grown dramatically among the two-year colleges during the past decade. In fact, the American Association of Community and Junior Colleges (AACJC), the Association of Community College Trustees (ACCT), and other higher education associations have identified hundreds of postsecondary institutions that offer literally thousands of such programs. The cooperative programming ranges all the way from basic communications skills to CAD-CAM programs and other high technology specialties. Clearly, there is a trend nationwide of more and more companies putting their skill training in community colleges, where the colleges are better equipped and staffed to handle it. Most of these programs are local, but there are a few that are national in scope. For example, the Ford Motor Company, in concert with the United Auto Workers, is providing a tuition assistance program for laid-off hourly employees under its National Vocational Retraining Plan. The company and union work with Henry Ford Community College.

This is the college that houses the UAW-Ford National Development and Training Center. In a study of the first 600 applications approved for payment under the Plan during the first few months of its existence, Center staff found:

> "...they (the participants) strongly preferred two-year vocational education programs offered by local community colleges and technical institutes. These employees tended to select a full-time load of college courses, with the Plan paying for about 95 percent of tuition and compulsory fees."

Another example of such a national effort is the General Motors program to train automobile dealership technicians, a program that will draw upon more than 60 community colleges across the country as the training centers, when the program is fully developed.

This brings us to the point of this hearing.

The community colleges are very grateful to Senator Grassley for his authorship of S. 108, the bill he originally introduced in the last Congress. This bill aptly reflects the national interest in what community colleges are striving to do in order to address the specific skill needs of industry, to help rebuild the workforce the country must have to stay ahead of global competition, and to curb unemployment.

The need for state-of-the-art equipment has become a serious hardship to community colleges in their ability to respond most effectively to the skill gaps that are plaguing American productivity. Wherever you turn among the States, the community colleges universally identify state-of-the-art equipment for one or more technician courses as placed at the top of the critical-needs list.

Very often, the courses most acutely handicapped by this need are those in the rapidly developing technologies, such as electronics, computer sciences, and robotics, where the American economy is hardest pressed to meet global competition.

Mr. Chairman, the speed of change is dizzying. According to a study sponsored by the Urban Institute, over a five-year period about 10 percent of the labor force underwent one or more changes in machine technology. Another 12 percent experienced a machine change as a result of a position change not caused by a change in technology. This study concluded that technological advances changed two to three percent of all jobs yearly, change that affects 1.5 to two million workers in the U.S. annually. Further, the time gap between technological invention and private-sector application is narrowing; once 15 years, it is now three or four years. The result of these quick adaptations of innovations is that production processes change rapidly, requiring new skills on the part of the workforce. In fact, this process is now continuous and will require that workers and those who expect to enter the workforce continuously upgrade their skills so that they can adapt to the new machines and the new processes.

Change is not a quirk of this point in history; it will be a fact of our lives into the forseeable future. To keep up with this change, to provide opportunities to our workforce to learn new skills or to upgrade their present ones, and to do it on state-of-the-art equipment, we must have the help of business and industry -- and the Congress needs to provide incentives to the private sector to give us the help.

Let me be more specific about my own State, Mr. Chairman. In Iowa our community college equipment shortages are plaguing such vital programs as Data

Processing -- Computer Repair -- Health Technologies -- Electronics -- Industrial Technologies -- to name just a few -- all of which are part of the growing curriculum response to the high technology demand.

These revolutionary changes are taking place in the office and in the factory as well. Laser-beam technology in tool and die machinery, for example, is no longer the future -- but clearly represents the present. And, of course, we all are aware of the impact of robotics on the marketplace.

Our corporations expect us to train their future employees in a way that will easily adapt them to this technology. Instead, we, for the most part, are still using the standard equipment of the past several decades -- equipment which is far removed from the state-of-the-art.

At Kirkwood Community College, for example, in our machinist program, we still have some machinery which pre-dates World War II. To replace this with just one or two laser-beam machines, would cost hundreds of thousands of dollars -- something clearly beyond our financial ability and the State's as well.

In nearly every area of training, the technological revolution is exploding before our eyes. Without proper equipment to train the workforce, Iowa's unique and responsive system will surely begin to seriously lag behind.

This past session, the Iowa Legislature did pass a new law that will provide a small property tax levy beginning next year to assist with equipment needs.

Senators, this is a commendabale effort on Iowa's part -- but wholly inadequate. The tax levy will generate $190,000 dollars for Kirkwood; yet, the current need at Kirkwood runs into the millions of dollars just to become part of the high tech century. It will take 10's of thousands of additional dollars to maintain any type of continued renewing of that equipment.

With property taxpayers nearing the limit of their endurance, with States struggling to avoid massive insolvency, and with the Federal Treasury empty, the only direction left to turn is to the private sector -- yet, with the current state of the economy, they need some incentive to be able to respond as they and we desire.

S. 108 establishes such an incentive.

At the back of my written testimony you will find briefs and tables from various States which document the more serious equipment needs of their community colleges. Ironically, the full scope of the need cannot be documented nationally, because there are States that have told their colleges they should no longer report their equipment needs, simply because those States lack the budget capacity to meet those needs. The fact is that many States are having difficulty financing basic higher educational services. A recent study shows how several States have been severely affected by economic downturns in the last ten years. The State Investment in Higher Education, 1983 reports that State appropriations for public higher education in 30 States increased by less than three percent or actually fell during the ten-year period. When appropriations were adjusted for inflation, funding for the institutions fell in eleven States, including: Indiana, Oregon, Vermont, Connecticut, Missouri, Pennsylvania, Maine, Wisconsin, New Jersey, Michigan, and Illinois. The five hardest-hit States were: Illinois (-14 percent), Michigan (-11 percent), New Jersey (-9 percent), and Maine, and Wisconsin (-8 percent). The five States that fared the best during this period were: Alaska (+187 percent), Wyoming

(+128 percent), Oklahoma (+110 percent), Texas (+89 percent), and Alabama (+71 percent). Iowa, by the way, ranked 18th in the nation, showing a 31 percent increase in appropriations in the ten-year period.

Given the pressing state of productivity and employment in our country, and the urgency of the challenge to the American economy and American technology, the reasons for allowing tax incentives to firms that make state-of-the-art equipment gifts to technician training programs in the community colleges, and other associate-degree granting institutions, are easily as strong and clearly as much in the national interest as providing such incentives for equipment given to university research. Both serve the same utimate need. Regardless of the volume of talent the country might pour into science and engineering, our eminence in these fields and our leadership in emerging technology will never be secure, unless it has the solid foundation of an adequate supply of advanced highly trained technicians.

Mr. Chairman, the two organizations that I am speaking for here, the Association of Community College Trustees and the American Association of Community and Junior Colleges, strongly endorse S. 108 and urge its adoption by the Senate.

Mr. Chairman, thank you for the opportunity to share our concerns and ideas with you and your Committee. We would be pleased to respond to any questions you may have.

UTAH SYSTEM OF HIGHER EDUCATION
STATE BOARD OF REGENTS
807 East South Temple • Suite 204 • Salt Lake City, Utah 84102 • Telephone 801-533-5617
ARVO VAN ALSTYNE
Commissioner and
Chief Executive Officer

July 27, 1983

Dr. Frank Mensel
Am. Assoc. Com. & Jr. Colleges
One Dupont Circle, N.W. --Suite 410
Washington, D. C. 20036

Dear Frank:

Subject: Utah Vocational Education Equipment Survey Report

BACKGROUND

In January, 1983, the Utah System of Higher Education (USHE) commissioned the Brigham Young University to determine both the amount and the usefulness/useability of direct, instructional-related vocational education equipment used in the USHEs eight colleges and universities offering vocational education programs. In all, 104 vocational programs (collapsed into seven standard categories: Health, Office, Technical, Trade and Industrial, Agricultural, Home Economice, Distributive Education) were offered among which 198 diploma, certificate or degree levels of completion could be earned. The eight USHE institutions consisted of five community colleges, two four-year colleges and one university.

All current equipment with a dollar value of at least $250 and having an expected usefulness/useability of one year or more was included in the study. Faculty members in each program at each institution prepared each inventory report. The report was thereafter reviewed by either the department chairman or dean and also by the institution's vocational director. Vocational program advisory committees --representatives from the specific occupation in business and industry also were consulted to validate the usefulness/useability index of the equipment.

UNIVERSITY OF UTAH
Salt Lake City
1850
UTAH STATE UNIVERSITY
Logan
1888

WEBER STATE COLLEGE
Ogden
1889
SOUTHERN UTAH STATE COLLEGE
Cedar City
1897

SNOW COLLEGE
Ephraim
1888
DIXIE COLLEGE
St. George
1911

COLLEGE OF EASTERN UTAH
Price
1937
UTAH TECHNICAL COLLEGE
Salt Lake City
1947

UTAH TECHNICAL COLLEGE
Provo
1941

BACKGROUND --Continued

As each item of equipment was listed on the invertory, the following information was also listed:

- Units on hand
- Age in years since manufactured or acquired
- Origninal cost to institution
- Whether it was acquired as "excess" or "surplus" or "donated
- Its current usefulness/useability for effective teaching:
    - A. Equipment is obsolete in business/industry
    - B. Equipment is useful for training but is not used in business/industry
    - C. Equipment is currently used in business/industry
    - D. Equipment is state-of-the-art in business/industry
- Description of equipment needed to replace current equipment classified as A, B or C above
- Units of replacement equipment needed
- Cost of replacement equipment
- Projected years of useability of either currently useful or needed replacement equipment.

In addition, each program was asked to list "additional" items of equipment for which their was not a similar or equal item currently on inverntory. This inventory asked for the:

- Equipment needed
- Units needed
- Priority of Need:
    - Needed to be at state-of-the-art
    - Needed to be more current with business/industry
    - Nice to have
- Cost of equipment
- Projected years of usefulness/useability for effective teaching.

FINDINGS

Across All Programs Among All Eight USHE Institutions

- * Total units currently inventoried among eight USHE institutions: 7,755 units
- * Total original cost to USHE for currently inventoried equipment: $9.45 Million.
- * Weighted mean age for current equipment: 8.5 years.
- * Weighted mean years of projected usefulness/useability for "additional" equipment: 8.8 years.
- * Total current equipment which is obsolete: 10 percent.
- * Total cost to replace current obsolete equipment: $2.59 Million
- * Total current equipment which is either obsolete or not currently used in business/industry: 25 percent.
- * Total cost to replace current equipment which is either obsolete or not currently used in business/industry: 6.51 Million.
- * Total replacement units needed in USHE to bring equipment to a closer approximation of state-of-the-art: 5,534 units.
- * Total replacement costs for 5,534 units: $21.39 Million.
- * Total units of "additional" equipment needed beyond replacement needs to bring programs to closer approximation of state-of-the-art: 1,731 units.
- * Totat cost for "additional " equipment needed: $8.31 Million.

FINDINGS --Continued

Equipment Needs Across Eight USHE Institutions, By Program, to More Closely Approximate State-of-the-art

Program	Replacement Equipment Costs	Additional Equipment Costs	Total Equipment Costs	Percent Costs Needed
Off. Occup.	$ 2.26 M	$0.58 M	$ 2.84 M	9.6
Technical	6.30 M	0.36 M	6.65 M	22.4
T. & I.	11.41 M	6.58 M	17.99 M	60.6
All Others	1.42 M	.79 M	2.21 M	7.4
Totals	$21.39 M	$8.31 M	$29.69 M	100.0

Frank, I hope the data will be of value in your presentations before the various Congressional hearings on tax credits for equipment, on vocational education reauthoriztion, and on others. For some perspective, Utah's population is currently 1.65 million and growing. We need equipment not only to more closely approximate the state-of-the-art but also to provide for the tremendous growth which will hit the USHE in five years. Nearly 45 percent of all lower division full-time equivalent enrollments in the eight institutions studied are enrolled in vocational education programs.

Call me if you want some findings not reported above.

Dave
David R. Terry, Ph.D.
Assistant Commissioner

cc: Dean Griffin, AVA
Gene Woolf
Arvo Van Alstyne
Don Carpenter
Gail Norris

1184F

STATEMENT OF DR. RICHARD K. GREENFIELD, CHANCELLOR, ST. LOUIS COMMUNITY COLLEGE, ST. LOUIS, MO.

Dr. **Greenfield**. Thank you, Senator. Mr. Chairman, my name is Richard Greenfield. I am the chancellor of the St. Louis Community College District in St. Louis, Mo. I am speaking here on behalf of my own institutions as well as the two associations that were just mentioned by Wayne Newton. If my statement may be entered in the record, I will summarize my remarks.

Senator **Grassley**. Yes; it will be included in toto.

[The prepared statement of Dr. Richard K. Greenfield follows:]

TESTIMONY

by

Richard K. Greenfield
Chancellor
St. Louis Community College District
St. Louis, Missouri

Mr. Chairman, my name is Richard Greenfield. I am the Chancellor of St. Louis Community College, St. Louis, Missouri.

I deeply appreciate the willingness of you and your Subcommittee to consider the needs that are addressed in S. 108, and to allow the community colleges the opportunity to comment on those needs.

S. 108 and bills such as S. 1194 and S. 1195 that deal with the state-of-the-art equipment needs that plague technician training programs could be vital links in how effectively our country addresses the towering challenges that we face in science, technology, and productivity.

The challenges are larger than simply making fuller use of the Nation's human resources, larger than simply reprogramming and retraining the workforce. We are faced with building a workforce that can meet and outperform the global competition at its own level. This means that both the people who give the training and the people taking the training have to have every advantage that we can build into each and every technician program that directly or indirectly relates to national productivity. State-of-the-art equipment is indispensible among such advantages.

I know that I do not have to tell Members of this Committee what is at stake in this competition, and the revenues that will flow if we sustain our place at the front of the competition. It is our complete conviction that the productivity deriving from a successful national commitment to training will repay many times over the modest tax investment required to implement S. 108.

Mr. Chairman, some of your colleagues are concerned that this legislation will create a strain on the Treasury, the result of decreased tax revenues. A recent report prepared by the National Science Foundation assuages those concerns. The report contains preliminary results of an assessment of three research and development tax incentives provided by the Economic Recovery Tax Act of 1981. One of those incentives was the donation of equipment to universities for basic research purposes. Among the study's findings were:

- o less than $5 million per year would be lost to the Treasury through this law (as estimated by the Department's Office of Tax Analysis)
- o equipment donations are likely to increase because of the tax incentives and other factors
- o significant explanations for equipment donations include: suitability of equipment for college and university work, response to greater frequency of requests from postsecondary institutions, effort to "produce the scientific and technical skill-base necessary to keep the United States competitive in international markets," market development, public relations, and improved tax treatment.

What this report says very clearly is that if tax incentives are given to the private sector for equipment donations for postsecondary technical instruction, and if we ask the firms for such donations, they will be forthcoming. And the donation will cause little negative effect on the Treasury for the immediate term. For the longer term, equipment donations leading to a more highly skilled workforce and generating more productivity will in fact create a stronger and broader tax base. Eventually, the tax credit program described in S. 108 will pay for itself many times over.

Mr. Chairman, previously you heard testimony regarding the diminished level of appropriations that many public postsecondary institutions are receiving from state budgets as reported in a recent study by an organization of presidents of state colleges and universities. I thought you might like to know how each of the states that you represent fared in this study. These percentages have been adjusted for inflation and cover the ten-year period 1972-73 to 1982-83.

- Oregon: -3 percent
- Missouri: -5 percent
- Wyoming: +128 percent
- Colorado: +28 percent
- Hawaii: +23 percent
- Texas: +89 percent
- Montana: +33 percent
- Louisiana: +47 percent

It is clear that some states have done much better than others in meeting the support needs of their public postsecondary institutions. Others have not done so well. The facts are that 30 states increased their appropriations for public colleges and universities by less than three percent per year during this period; eleven states actually decreased appropriations.

The tragedy is that with modest advances in appropriations--or worse, with decreases--some of the basic components that maintain and improve higher education health and vigor are either eliminated or severely reduced. Faculty are cut, supplies and equipment budgets are sliced, and professional development activities are eliminated or curtailed.

It is not the responsibility of the federal government to make up for the inabilities of state governments to adequately support public higher education. But when it is possible, it is the responsibility of the federal government to create the sort of environment that will encourage the flow of support from other sectors. One of the resources that has been tapped inadequately in the past is the private sector. The 1981 tax laws stimulated increased equipment donations to universities for basic research. Now we need to extend that successful law to equipment donations to less-than-baccalaureate institutions for purposes of vocational/technical training, to provide professional development opportunities to faculty through assignments in local business and industry during non-teaching times, and to underwrite the appointment of industry professionals to teaching assignments in the colleges.

Mr. Chairman, in one, simple straight forward act, S. 108, three significant higher education needs are addressed. The legislation is important; it does address key concerns on the part of the colleges; it will trigger increased correspondence between colleges and the private sector; and it will not significantly reduce tax income for the country.

Mr. Chairman, we have great confidence that this legislation will successfully meet its purposes. Community, technical, and junior colleges have developed an exceptional track record in working cooperatively with local business and industry. Our colleges are offering literally thousands of employer-specific, tailored programs serving local business and industry. While many have been providing these services for years, the generation of such programs has increased dramatically during the last several years. At my own institution, for example, we have worked cooperatively with the following firms, offering them the programs identified below:

Firm	Program
Ford Motor Company	Applied Robotics; Technical Electricity
McDonnell Douglas	Computer Service; Quality Control
Emerson Electronic	Business Education

The programs that start out as employer-specific, serving learners who are already employed, often grow to serve the students who are seeking jobs including the displaced workers who are seeking new skills. Many can be and are given on-site, using the company's facilities and machinery. Yet to serve the larger workforce and the community, our campuses have to be equally well equipped.

To prepare employable workers ready to take on jobs immediately upon completing training and capable of handling the advanced processes and equipment currently in use in industry, we need to train them on machinery that is actually in use in the private sector. Much of this equipment is expensive--beyond our capacity to purchase in many cases, and, when we can purchase it, we are frequently saddled with it long beyond its currency in the workplace. In the latter case, the problem is exacerbated by high costs of maintenance and difficulty in securing parts, among others.

Other testimony you have heard reports on the speed at which change is occurring in the workplace, with as many as two million workers in the U.S. affected by machinery change annually. Marvin Cetron of Forecasting International nicely captures the situation, when he suggests:

> Training must be prepared to deal with vast and fast-paced changes as current jobs become obsolete and new ones are created, and must gear up to meet the challenge of massive technological, economic and social change. Lifelong learning will become a fact of life as people will require full-scale retraining every ten years for the 4-6 career changes they will undergo.

Keeping pace with change, keeping pace with the demands of those who require training and retraining, keeping pace with individuals who wish to change their occupations, and satisfying the needs of the national economy for a skilled, talented and energetic workforce--all require that our instructional resources keep pace, that we train for today's and tomorrow's positions, that we offer instructors who are up-to-date on current technology, and that we produce the kind of atmosphere that will invite workers to continue their skills development in institutions of higher learning.

Mr. Chairman, to give you one little glimpse of the enormity of the equipment issue in the State of Missouri, I asked my research staff to calculate the per year equipment purchase and lease needs of community, technical and junior colleges. The staff estimates that our colleges need $7,500,000 to make necessary purchases and $2,500,000 to lease instructional equipment. Our budgets to cover these necessary purchases and leases are $2,000,000 for purchasing and $400,000 for leasing.

Part of this shortfall can be covered through the incentives provided in S. 108. These figures represent the needs of the 20 two-year colleges in the State. Because state appropriations for public colleges in Missouri have not kept pace with inflation over the past ten years, these equipment figures may be relatively higher than those for other States, but my guess is that the need in other States is equally high. With some loose calculations, it would not be an exaggeration to say that nationwide our two-year colleges require at least $500 million dollars to purchase equipment and $150 million to lease equipment if they are to keep pace with the speed of technological change in the workplace. These figures compare to the $2.2 billion that the National Society of Professional Engineers estimated was needed to modernize instructional equipment in engineering school laboratories.

To dramatize our needs for instructional equipment, Mr. Chairman, consider these numbers; an 8 megabyte computer mainframe, just one of them, would cost the college $338,113. This figure is for the machine alone; it does not include the cost of maintenance, installation and related costs. The college's 1983 budget for equipment purchase totaled $546,938. Were we to purchase this single piece of needed equipment, it would consume 61 percent of our total equipment budget for this year.

This is not a unique story. Similar vignettes could be gathered from community, technical, and junior colleges across the country. For example, I was told recently by a president of a college in North Carolina that two of the 25 technical training programs that he offers at his institution needed to be upgraded. To upgrade the machinist program, he said he would need a $45,000 milling machine; improvements in his drafting program would require the addition of a $30,000 Computer Assisted Design system. He said his equipment budget this year is $61,000, not even sufficient to make needed improvements in just two of his 25 technical programs.

Also Mr. Chairman, a technical college in another State reported recently that a nationally known firm in its district spent $250,000 to update its tool and die shop. The firm did not replace equipment; it simply improvad and adapted the machinery it had already. The technical college offers 16 technical program curricula. If it tried to keep pace with industry in upgrading its shops, it would require nearly three times its available annual equipment budget ($100,000) to do so--for just one program area!

Mr. Chairman, I would like to offer you just one example of the difficulty some institutions are having in hiring and maintaining qualified faculty for some of the important technical and science programs in our colleges. A dean from one two-year college reported a short time ago that he was frustrated in hiring a faculty person for an electronics technology program. He said the person he wanted to hire had just the qualifications he desired and would have made an important contribution to the quality of instruction offered students in that program. Also, the person wanted very much to teach at the college. But, he could not afford to accept the position. The college could only afford to pay him $16,500, a figure that was $5,000 less than what a local firm offered him. And the salary increase potential at the firm was much greater than the college could offer.

Mr. Chairman, our colleges and universities frequently have this problem. We cannot afford to pay the salaries or meet the salaries that industry is willing to pay for professionals in certain disciplines. One major resource for filling in faculty gaps produced by the enticements of higher industry salaries is to encourage local business and industry to loan us their best people for some of those courses in which we are experiencing critical instructor shortages. We already hire large numbers of adjunct faculty to supplement our fulltime faculty and to offer expert instruction in basic and specialty programs. We need to extend this procedure to include those technical experts in business and industry who might not be freed to help in the classroom if tax incentives were not provided to their firms.

The faculty shortage problem is national, Mr. Chairman. In a national survey completed earlier this year, we discovered that there are critical faculty needs in several technical/science areas. Selected results are shown in the following chart.

Selected Results of AACJC National Survey of Instructor Shortages

	Critical Faculty Shortage*		Faculty Shortage*	
	Computer Science	Electronics	Computer Science	Electronics
Region II	70	23	30	47
Region VI	40	18	48	38
Region VII	38	22	47	31
Region IX	54	30	33	43
Region X	33	19	48	56

* Figures indicate percentage of those institutions responding to the survey.

Individuals with the skills and training we need for our classrooms are available, Mr. Chairman, but we cannot hire them because of salary differentials. S. 108 would help us overcome the shortages we are experiencing in these crucial academic areas.

One final point, Mr. Chairman. This country rises or falls on the strength of its human capital. As one labor economist recently stated: "The key to economic progress lies less with the accumulation of physical capital and more with the broadening and deepening of human capital, since it is human talent alone that is capable of inventing, adapting and maintaining machines....As the pace of technological change accelerates, competitive advantage depends on our ability to adapt, to apply new technologies....optimal shifting of human and machine resources will be required, as will the constant retraining of the workforce."

To broaden and deepen our human capital, to sharpen and consistently improve our Nation's talent, and to compete aggressively in the world economy, we need the cooperation of the business sector of our Nation to work with our education institutions —and we need the provisions of S. 108 to encourage business to work with us.

Speaking for my institution, for the American Association of Community and Junior Colleges, for the Association of Community College Trustees, and for the AACJC/ACCT Joint Commission on Federal Relations, I enthusiastically endorse S. 108.

Thank you for the opportunity to present this position.

Dr. **Greenfield**. Senate bill 108, which you have developed, and bills somewhat similar in nature, such as S. 1194 and S. 1195, deal with up-to-date equipment needs that plague technician training programs in all of our institutions. They could be vital links in how effectively our country addresses the serious challenges that we face in science, technology and productivity. Both the people who are giving the training and the people who are taking the training have to have every advantage that we can build into the technician programs that directly or indirectly relate to national productivity. State-of-the-art equipment is indispensible among such advantages.

A recent National Science Foundation report on the results of the R&D incentives provided by the 1981 Economic Recovery Act says very clearly that if tax incentives are given to the private sector for equipment donations for postsecondary, technical instruction, and if we ask the firms for such donations, that they will be forthcoming. And the donation will cause little negative effect on the Treasury for the immediate term. For the longer term, equipment donations leading to a better developed and skilled work force which will generate more productivity actually will create a stronger and broader tax base. Eventually the tax credit program which you have described in Senate bill 108 will pay for itself many times over.

Admittedly, it is not the responsibility of the Federal Government to make up for the inability of State governments to currently support public higher education in an adequate fashion. That is the case now in at least 30 or more of the States. But when it is possible, it is the responsibility of the Federal Government to create the kind of environment that will encourage the flow of support from other sectors, and one that has not been tapped adequately up to now for the public institutions is the private sector.

The 1981 tax law stimulated increased equipment donations to universities for basic research. Now we need to extend that successful law to equipment donations to less than baccalaureate institutions for purposes of vocational and technical training, to provide professional development opportunities for faculty through assignments in local business and industry during the downtime—typically in the summer—and to underwrite the appointment of industry professionals to teaching assignments in the colleges.

In one rather simple straightforward act, your bill, S. 108, these three significant higher education needs are addressed. The legislation is important; it does address these key concerns on the part of the colleges; and it will trigger increased cooperation between the colleges and the private sector. And, above all, since this has been mentioned earlier this morning in connection with all of the bills under consideration, it will not significantly reduce tax income for the country.

We have great confidence that this legislation will successfully meet its purposes. The community colleges have developed a very good track record in working cooperatively with business and industry. At my own institution, for example, our three colleges have worked cooperatively with various firms, such as the Ford Motor Co., McDonnell Douglas, and Emerson Electric in offering programs specifically to meet their needs in such fields as applied robotics, technical electricity, computer science and computer technology, quality control, and business education. To prepare employable workers ready to take jobs immediately upon completing training and capable of handling the advanced processes and equipment currently in use in industry, we just have to train them on the equipment that is actually being used and not on 10-year-old or obsolescent stuff. And most of that equipment is beyond our means to buy or to lease.

Just to give you one glimpse of this problem for the State of Missouri, we have ascertained that the State's 20 community colleges would need $7,500,000 annually to make the necessary capital purchases and $2,500,000 to lease instructional equipment. Our current annual budgets provide only $2 million for purchasing and $400,000 a year for leasing. Part of this shortfall could be covered through the tax incentives provided in Senate bill 108. While I know that the time is very short, I do feel that it is necessary to stress the difficulty we have in hiring and keeping key faculty members in technical areas. It is a very simple fact that we cannot afford to match the salaries that they can receive in private industry. As a result, we either cannot get them or we lose them within the first 2 years of employment. Any incentives that would allow us to use people from business and industry that are on loan would be very helpful, as well as incentives to keep our current faculty up to date in their fields. That is a very important part of the problem we face today. If they are not familiar with current equipment, and are not familiar with current practices by actually working in that field, they rapidly are teaching the wrong things to the right kind of people, unfortunately. So we appreciate Senate bill 108 and its intent, and encourage its passage.

Senator **Grassley**. Thank you. I have questions of each of you, and although they are directed at specific members of the panel, I would appreciate it very much if any of you feel you would like to contribute to please answer even if the questions are directed toward someone else. I want to ask you, Mr. Conkling, do you see a future benefit to your company from the staff development provisions in my bill? Particularly, will the hiring of instructors give you more input into curriculum taught in training programs able you to identify and recruit promising students. Are there any other benefits I failed to mention?

Mr. **Conkling**. Absolutely. We think that is one of the most attractive features of this program. Oftentimes this legislation is discussed just in terms of equipment. As manufacturers of scientific equipment, we believe getting equipment into schools is fundamental. As was just mentioned by the previous witness, you cannot employ people from schools who have been trained on old equipment no longer in use in your assembly area.

But even more important is making sure that classes taught are up to date. That's the best way to get good students—the best students if possible—who have the most upward mobility and the best chance to make productivity gains.

A lot of our companies are profit-share companies, so well-trained students help themselves by making the enterprises themselves more productive. We think that is one of the most attractive features of your legislation.

Senator **Grassley**. Dr. Greenfield, from the standpoint of your community college district, do you find that you are unable to offer programs utilizing new current technologies because of the lack of money to initiate such courses? We are talking basically about new programs. In your testimony you talked more about what you are doing right now.

Dr. **Greenfield**. Well, it is not only shying away from some of the new program areas, but it is updating some of our engineering technology programs. The cost of numeric control machines and the computerized equipment in the science and engineering areas, as well as in the allied health areas, makes it very difficult for us to keep our present programs up to date as well as to consider offering laser optics or other new programs. It is a serious problem.

Senator **Grassley**. Do you feel, Dr. Greenfield, that the tax incentives in my bill are sufficient to encourage additional equipment donations and the lending of faculty from industries that you have worked with in the past?

Dr. **Greenfield**. We have a good deal of that already happening without the tax incentives. What we would like to see—and I think it will happen through this bill—is that many of the companies that are "on the edge," which we have been talking to for a decade or more about the need for closer linkages, will be encouraged to donate more state-of-the-art equipment instead of equipment that they are phasing out. I mean that is what we experience over the years. We got the equipment that they are beginning to shy away from as they replace it. And I think this incentive will give them enough cause to give us state-of-the-art equipment instead of the slightly older equipment.

Senator **Grassley**. From the standpoint of the private sector, do you agree with that, Mr. Conkling?

Mr. **Conkling**. I think Dr. Greenfield is correct. Currently, my company is already in the education business.

Community colleges in Oregon, according to a survey by the Department of Education, face a $5 million shortage of equipment and a shortfall of $16 million to come up to industry standards. Because of the advanced areas in which we need technicians, we were forced to literally create programs ourselves with our own equipment. We are willing to do that, but we feel we are better at making oscilloscopes and other electronics equipment instead of being in the education business. We have worked very closely with our community colleges to shift our classes to them. One helpful element in that equation is to give companies have an additional marginal benefit.

And it is a marginal benefit, but still enough of a benefit to tip the scales in favor of providing state-of-the-art equipment, that latest equipment you just made, not the equipment that is being phased out.

One other additional factor is contained in my prepared testimony and pertains to a very small company. We have talked mostly today about large companies, but Siltec Corp., in Salem, Oreg., is coordinating with Chemeketa Community College very profitably. The company is a startup company, but is already contributing one of its people to program instruction at Chemeketa Community College—and has donated $500,000 worth of new equipment.

You will find startup companies even more inclined to provide state-of-the-art equipment to schools.

Senator **Grassley**. Mr. Newton, we recently had an Iowa Vocational Education Association survey that revealed equipment needs were the single most important factor to be addressed in improving vocational training programs. How does the present situation at your institution fit in with that survey? Are you typical or worse or even maybe better off than most town institutions?

Mr. **Newton**. Well, Senator, I am not exactly certain that I would agree entirely that equipment needs overcome the people needs. I think an illustration of our own agriculture department—I need to demonstrate my position on this—our own instructors who have been around, many of them since legislation which you are involved in created the community colleges, because of funding and other reasons, have not adapted to the computer skills that we now find being used on modern day farms. It seems to me like we need to give the computer lands—the Radio Shacks, other private companies—the incentive to come in and either train, or our people, or come in and teach those courses so that our future farmers can be exposed to those skills and not be sent out into their field of endeavor with half an education.

I am not so certain that I would agree that equipment, I think they are equally as important. As you well know, most of our colleges, being 15 and 16 years old, a number of those vocational instructors have been out of the field for that length of time. We have not had the resources to put them back in those skills. Your bill would give the companies the incentive to both invite them into their employment as well as send their employees to train our students. So I guess I am not willing to say that the shortage of equipment outweighs the human needs. However, you can easily see that in reference to the agriculture program that I referred to, the computer is absolutely as essential to that class as the training instructor. So on balance, I would say they are equally as important.

Senator **Grassley**. I am not sure that I want to disect my bill to quite this extent. From the standpoint of certain incentives for the donation of equipment versus the incentive for the exchange of personnel back and forth, do you think one part of the bill is going to accomplish our goal better than another part of the bill, or do you think they will both be about equally effective?

Mr. **Newton**. Well, not being aware of the politics of the matter, Senator, you know, the equipment things are absolutely essential because of the high cost. It is an easy little thing to manage. If a company would choose to contribute to us, they handle the paperwork. We issue a receipt, as I understand it. That is virtually the mechanics of the matter. So that part of it would be the simplest part to administer and to accept. The other part would be a little more difficult in the credit and so on. So obviously as a leader in the community college field, we are going to accept what part of the bill that you manage to pass. But we would prefer to have it all.

Senator **Grassley**. All right.

Dr. **Greenfield**. I would concur in that we simply cannot afford to get the equipment through purchase, as much as we need it.

Just one significant piece of equipment could take up more than half, for example, of our annual capital equipment allocation. Since we do not receive state aid for capital equipment in our State, it is all local money that has to provide for it. I think though of the two personnel related aspects of your bill, the more important one would be encouraging the loan of employed people to teach in our institutions rather than the secondary one of encouraging companies to receive our staff in off times. We have other ways of accomplishing that. For example, through sabbatical leaves for purposes of return to industry, where we provide part of the salary, so that the company is encouraged to employ the person for longer periods of time than a couple of months, for 6 months or for a year. And that can be more effective. So I would put them in that order of priority.

Senator **Grassley**. I assume in your position as chancellor that you would see this bill as a new tool to communicate with private industry to get help that you don't have now, or are you communicating with these people anyway?

Dr. **Greenfield**. We are communicating right now. I think that what this does is give an additional incentive for more cooperation than exists even at the present time. But we have been working at it through advisory committees for each of our technical training programs, and the like, in developing this dialog with important people in the labor movement as well as in the management of the companies too, for various purposes, but primarily to be able to keep our present instructional programs and curriculums as up to date as we can make them. But the liabilities of our inadequate equipment and what I feel is our staff becoming more obsolescent as time goes on, without the additional people coming in and the turnover we would like to see, is a significant problem.

Senator **Grassley**. Let's suppose you already have good relationships with local businesses, do you are already out there, you really think a piece of legislation like this would facilitate that sort of communication and cooperation?

Dr. **Greenfield**. Yes, it certainly will.

Senator **Grassley**. Even considering the strong relationships with business in your community college area?

Dr. **Greenfield**. Yes.

Senator **Grassley**. Wayne?

Mr. **Newton**. Senator Grassley, I would just like to confirm that feeling. As you know, in our own State of Iowa when the community college bill was written, we were probably at a point in time when we provided people with high school diplomas and industry accepted them and said they could do whatever the standards of the K-12 system mandated, and they virtually took it upon themselves to train those people in whatever manner of work that they chose for them until today when industry has learned to expect from us a job entry level skill. I think that with the high cost of equipment and training we have got to come back and bring the pendulum back to the middle to some degree, and we are doing that on a voluntary basis. But this piece of legislation gives us a new carrot or a new tool in our arsenal to go out and attract those folks to come and cooperate with us. And we don't do it in the way of having a handout to do it. It is done in such a way that they have an incentive by virtue of the tax credit. And I think it is an interesting concept, and it will very much put new people on our doorstep, folks that we would not have expected to ask us to do things cooperatively with before.

Senator **Grassley**. One last question relative to the private sector. Do you think that the business community will find personnel transfers too disruptive of their workforce and their accounting procedures?

Mr. **Conkling**. No, absolutely not. It would be far less disruptive than having to set up our own educational institution. And, if I could also comment on the previous question in light of this response, I believe your bill is an extremely effective one, but still a modest measure. You should not feel obligated to choose between one element or the other, because we are doing too little as it is to invest in our own people and our own educational institutions which translates into job opportunities and industrial competitiveness. I think both representatives from community colleges have indicated that cooperation is producing results today. The question is, both from their vantage point and from our vantage point, that we are not cooperating fast enough. Other people in the world are making strides faster than we are. And your bill must be seen as only a healthy beginning, not the end of what we must do to catch up with competition in the world which, whether we like it or not, is not just coming from Japan, but also from countries such as Brazil and others that we traditionally have not regarded as competitors.

Senator **Grassley**. I want to thank all of you very much. This is the end of my questions. Because other members could not be here, you might receive some questions in writing and the subcommittee would appreciate your response; second, the record stays open, I think, for 7 days. If there is anything you want to add to your testimony, or if there is anyone who wasn't invited to testify who would like to contribute testimony, it is received as a matter of procedure. Thank you all very much. The meeting will stand adjourned until 2 o'clock this afternoon.

[Whereupon, at 12:24 p.m., the hearing was recessed, to reconvene at 2 p.m. this same date.]

Mr. **Armstrong**. In Colorado Springs, Colo., there exists today a unique private sector partnership that channels the profits from free enterprise into meeting individual and community needs that would otherwise remain unfilled.

For the past 42 years, the after-tax profits earned by the historic Broadmoor Hotel in Colorado Springs have been channeled through its owner, the El Pomar Foundation, to help fund civic and charitable groups throughout the state. With the Broadmoor as its cornerstone, more than $65 million has been contributed by the El Pomar Foundation to help meet the needs of the penrose Hospital for Cancer Research, Colorado College, the University of Denver, the Chicano Education Project and more than 300 other such groups.

But this creative and productive partnership is threatened by requirements proposed by current tax law. The bottom line is this: Unless current law is amended, the El Pomar Foundation will be forced to lose majority ownership of the Broadmoor, and the Broadmoor will probably no longer—to the regret of the State of Colorado and to the Colorado Springs community—be locally controlled or operated.

Today, Senator Hart and I are jointly introducing legislation which will stop this forced divestiture which is now required by an overly broad and misguided provision contained in a 1969 tax law.

When Congress wrote the 1969 law, some individuals created foundations to escape payment of estate taxes on inherited famiy enterprises. To stop this practice, Congress enacted legislation requiring all foundations—even if there was no hint of tax fraud or abuse—to divest themselves of majority ownership of all enterprises. As a result, the El Polmar Foundation must divest itself of 50 percent of its Broadmoor stock by 1989, and an additional 15 percent of its stock by 2004.

One irony surrounding the El Pomar's forced divestiture is that in drafting the 1969 law the U.S. Senate approved a provision which in large measure exempted the Broadmoor from the divestiture requirement for at least 36 years. At the time, the Senate believed, as I do today, that the factors that led to the foundation legislation in 1969 are not present in the El Pomar Foundation. In fact, none of those operating the Broadmoor or the Foundation are descendents of Spencer Penrose, the original founder of the Broadmoor and the Foundation.

The legislation Senator Hart and I are introducing today exempts the El Pomar Foundation from the divestiture requirements imposed by Section 101(1) of the Tax Reform Act of 1969.

There are several compelling reasons why S. 1464 should be enacted:

One, profits now earned from the Broadmoor Hotel's operations are channeled through the El Pomar Foundation in to civic and charitable projects throughout Colorado. A forced divestiture would adversely affect this partnership.

Two, under present law prospective buyers could take unfair advantage of the Foundation since it has a legal mandate to sell in the future.

Three, the factors that led to the 1969 law are not present in this case. Both the Broadmoor Hotel and the Foundation are totally free from the influence of the grantor or the heirs.

Four, there would be no revenue loss if this proposal is enacted into law since the Boradmoor Hotel is subject to the corporate income tax law regardless of ownership by the El Pomar Foundation. Although the El Pomar Foundation is exempt from Federal Income Tax law, the Foundation, like all foundations, is subject to the private foundation excise tax on its investment income.

Five, there is precedent for this legislation since the U.S. Senate has earlier approved similar legislation.

Six, the Broadmoor Hotel is locally owned and managed, and is a bedrock of the Colorado Springs community. It is the city's second largest employer, and the Broadmoor subsidizes hundreds of community activities. Because the Broadmoor is such a unique and valuable asset, financial analysts believe that only corporations now located outside the State would be able to purchase the Broadmoor. So the likely result of a forced sale of the Broadmoor, as now required by law, would be nonresident absentee ownership. One indication of the opposition to absentee ownership of the Broadmoor is an editorial accompanying my remarks that was recently published by the Colorado Springs Gazette Telegraph, the city's largest newspaper.

Mr. President, the Armstrong-Hart bill merits quick hearings and early enactment. Let me point out that this is not a controversial bill. In fact, it has unanimously passed the Senate Finance Committee on a 19–0 roll call vote. It has also twice passed the United States Senate . . . again by unanimous votes. The only thing preventing the quick enactment of this legislation is the House of Representatives. They have rejected the amendment in conference with the Senate. But I trust this attitude will change now that the House Ways and Means Committee is scheduling hearings on the issue. I look forward to working with the House on this issue.

AFTERNOON SESSION

Senator **Armstrong**. The committee will come to order. This afternoon we are meeting to hold hearings on two bills, S. 1464 and S. 1549. S. 1464—exemption for divestiture requirements of excess business holding provisions for the El Pomar Foundation.

Senator **Armstrong**. Our first panel is Mr. William Hybl of the El Pomar Foundation, and Mr. William Morris, representing the Altman Foundation. Gentlemen, would you come up to the microphone and take your places? As you are well aware, the committee has dealt with S. 1464 in substance before. And so it is my thought that a lengthy hearing is not necessary, but in order to just update the record on this, we thought it would be worthwhile to get some current testimony and perhaps to ask a question or two in response to some issues that were raised this morning. Mr. Hybl, we are very glad to have you with us, and we would like to have you proceed however you would like to.

STATEMENT OF WILLIAM J. HYBL, PRESIDENT, EL POMAR FOUNDATION, COLORADO SPRINGS, COLO.

Mr. **Hybl**. Thank you, Mr. Chairman. I am Bill Hybl, president of the El Pomar Foundation. I would ask that my written statement be included in the record, and I be given time to summarize some of the areas covered in asking for support of S. 1464.

The El Pomar Foundation was started in 1937 by Spencer Penrose, who was owner of the Broadmoor Hotel. A 100-percent ownership of the Broadmoor has always been with Mr. Penrose and now with the El Pomar Foundation. After the Tax Reform Act of 1969, several items occurred of interest. The El Pomar Foundation has divested 11 other separate companies over the last 15 years. Good business judgment and criteria which the trustees used in their fidiciary duties were the basis for El Pomar Foundation retaining the Broadmoor Hotel. I would like to go into three areas before I address the specifics of section 4943 of the Internal Revenue Code.

First, the Broadmoor Hotel has been an appreciating asset which, through the years, increased the ability of the El Pomar Foundation to make charitable distributions throughout the State of Colorado. Second, Broadmoor Hotel represents less than 20 percent of the assets of the El Pomar Foundation. The hotel certainly has been a significant contributor with its appreciating value and its current dividend income to the foundation. The third reason is that the Broadmoor is a part of the local history and focus of the Pikes Peak region in Colorado, just as many other foundations who have presented their cases are part of their regional history. The foundation would regret being in a position where the Broadmoor Hotel was sold to an offshore interest, multinational corporation or a large hotel chain. The fact is the hotel is a profitable entity, a holding which has been very good for the El Pomar Foundation as an investment. The foundation has not been directly involved in day-to-day management of the hotel. In fact, there is a group of good managers that run the hotel, while the foundation is operated separately.

The El Pomar Foundation started with just $18 million in assets, but since 1937 has made grants of $75 million, and still has a corpus of something in excess of $110 million being used for charitable good in the State of Colorado. Grants have included public charities that are traditional, nontraditional, and new institutions with innovative ideas throughout the State. There are no lineal heirs of the founders, Mr. and Mrs. Penrose, involved as officers or directors in either the El Pomar Foundation or Broadmoor Hotel. This has been a major concern expressed by the Treasury through the years but does not apply in this case Broadmoor Hotel pays full taxes—Federal, State and local—and is not involved in unfair competition with any similar taxpaying entity. Section 4943 has been an impediment to the foundation in its conduct of business and restricts the way in which the trustees exercise their fiduciary responsibilities. We would share comments and endorse statements which indicate that repeal of section 4943 is appropriate. The ownership of Broadmoor Hotel by the El Pomar Foundation is a clear example that there should be latitude involved in section 4943, and we would urge the committee to support S. 1464. Thank you, Mr. Chairman, and members of the committee.

Senator ARMSTRONG. Thank you, Mr. Hybl. I have a question or two for you, and perhaps Senator Long will as well, but before we get to that, let me call on Mr. Morris who is here to represent the Altman Foundation. Would you tell us a bit about that? I am not as familiar with the facts of the *Altman Foundation* case, although I am generally familiar with it. But perhaps you could take a minute in your statement to give us some background on that. And I take it that what you are seeking, if that is not clear from your statement, that you would spell that out. So far as we know, the Altman Foundation would not be covered by this specific bill, but I gather you are seeking some similar relief.

[The prepared statement of William S. Hybl follows:]

TESTIMONY OF
WILLIAM J. HYBL, PRESIDENT
EL POMAR FOUNDATION
AUGUST 1, 1983

Mr. Chairman and Members of the Subcommittee, my name is William J. Hybl and I am President of the El Pomar Foundation. I appreciate the opportunity to testify before you on the subject of Excess Business Holdings by private foundations.

Organized in 1937, the El Pomar Foundation has a forty-six year history of philanthropy within the State of Colorado, having made grants in excess of $75,000,000. This statement sets forth a history of the El Pomar Foundation and respectfully requests relief from Section 4943 (Foundation Excess Business Holdings of the Internal Revenue Code).

It is helpful to understand the background of the El Pomar Foundation and its one hundred percent ownership of the BROADMOOR Hotel, Inc. The BROADMOOR Hotel was built in 1918 in Colorado Springs, Colorado by Spencer Penrose. It was intended and continues to be one of the truly fine resorts in the world. Prior to his death in 1939, Spencer Penrose directed the charitable purpose of the Foundation was to use the principal and income of the Foundation "for such charitable uses and purposes (including public educational, scientific and benevolent uses and purposes) exclusively as will, in the absolute and uncontrolled discretion of the trustees of the corporation most effectively assist, encourage and promote the general well being of the inhabitants of the State of Colorado".

Penrose, was one of the pioneers in the development of the Pikes Peak region of Colorado. He first came to Colorado Springs in 1891. Over a period of the next twenty-five years he accumulated a substantial fortune from real estate and mining activities in the area. His first big strike came from his ownership of an interest in a gold mining claim, the Cash on Delivery Mine in the Cripple Creek, Colorado area. His largest gains were made from the Utah Copper Company which was formed by him and his associates in the early 1900's. The Utah Copper Company was ultimately merged into Kennecott Copper Company in 1923.

In 1915 Spencer Penrose began to turn his attention from mining to the investment of his fortune and other interests which were of a less profitable but more satisfying nature. In 1915 he commenced the construction of an automobile highway to the summit of Pikes Peak, which was completed in 1916. He inaugurated the Pikes Peak Hill Climb race for automobiles which continues today. The Pikes Peak Highway has been donated to the government and is now operated by the City of Colorado Springs.

As previously indicated, the Foundation has made charitable grants of over $75,000,000, including The Colorado College, The Penrose Hospital for Cancer Research, the Regional Library for the City of Colorado Springs, the University of Denver, Chicano Education Project, Domestic Violence of Colorado Springs, and Silver Key Senior Services. (Appendix A) The Foundation has placed an emphasis on capital construction programs and rehabilitation of existing facilities.

The Foundation has continued to own the BROADMOOR Hotel and hire management which has oriented itself to the needs of the people of Colorado Springs and Colorado in general. The trustees of the Foundation have consistently placed service to the community and the general welfare of the residents of the State of Colorado as highest on their list of priorities. The BROADMOOR Hotel is subject to the corporate income tax imposed by Section 11 of the Internal Revenue Code in the same manner as other hotel corporations, or any tax-paying corporation for that matter.

There is no donor control of El Pomar Foundation. Its founder, Spencer Penrose, died in 1939 and his wife in 1956. Since then there has been no member of the Penrose family associated with the Foundation or its holdings in any capacity. There have been no instances of self-dealing, and the Foundation has consistently distributed its income for charitable purposes on a current basis in compliance with prevailing law. (Appendix B) The trustees have never made any investments which were not motivated by the specific charitable purposes of the Foundation or which would in any way jeopardize the ability of the Foundation to do so. The Foundation. prints and distributes an Annual Report with financial statements, guidelines and other correspondence so that prospective grantees will know how the funds of the Foundation are available, being managed, and distributed for their benefit.

During consideration of the 1969 Tax Reform Act the Senate Finance Committee received written testimony from the trustees of El Pomar Foundation urging the Committee to delete the provision in the

House-passed Bill requiring private foundations to divest their excess business holdings. The trustees' testimonies set forth the history of the El Pomar Foundation, the charitable activities of the Foundation and the adverse effects on the Colorado Springs community if the BROADMOOR Hotel were required to be sold by the Foundation.

> "Our greatest concern is the future of the BROADMOOR Hotel. If the Foundation were required to sell The BROADMOOR the only potential purchasers who could afford to purchase it would be major hotel chains or perhaps one of the large conglomerate corporations. In either event the result would be absentee ownership by an organization which had no special interest in the welfare of Colorado Springs or the inhabitants of Colorado generally. Indeed, management of such an organization would probably not even be aware of many of the problems of the area. Any organization which was oriented primarily towards the profit motive rather than public service would undoubtedly curtail many of the activities presently being conducted by The BROADMOOR . . . We submit there is nothing inherently bad in having a charitable foundation own a controlling interest in a business enterprise. We see nothing wrong in having the profits of an operating business corporation inure to the benefit of the public at large, rather than just to certain private stockholders. We think the public welfare is better served by having the beneficial ownership of the BROADMOOR Hotel in the

citizens of the State of Colorado rather than the stockholders of some major hotel chain corporation . . . "

Senator Gordon Allott of Colorado testified in 1969 before the Senate Finance Committee in support of the written remarks of the trustees of the El Pomar Foundation (Senate Finance Committee Hearings, page 4357). In response to this testimony, the Senate Finance Committee provided a grandfather clause for the El Pomar Foundation. The grandfather clause, which would have allowed retention of the BROADMOOR Hotel by El Pomar Foundation, was passed by the Senate; however, was then omitted in the Conference Committee Report. The current law, Section 4943, as approved by the Conference Committee and signed into law by the President in 1969, provides that a business that is one hundred percent owned by a private foundation as of May 26, 1969, is required to accomplish a three-stage period of forced divestiture:

(1) During the twenty year period, 1969 through 1989, the private foundation may continue to own 100% of the stock of the business.

(2) By May 26, 1989, however, the foundation must reduce its ownership to 50%.

(3) Finally, by May 26, 2004, the foundation must reduce its ownership by 35% where it may remain forever.

El Pomar Foundation seeks legislation which would recognize its position as a foundation established over forty-five years ago with no substantial contributors or their lineal heirs associated with its operation for the past twenty-five years.

The legislation before you today proposes the El Pomar Foundation be exempted from the divestiture requirements under Section 4943 of the Internal Revenue Code. The El Pomar Foundation would submit the following:

Existing law allows any and all prospective buyers of the El Pomar Foundation's interest in the BROADMOOR Hotel to take unfair advantage of the Foundation since the Foundation is under a legal mandate to sell at least fifty percent of its interest in the Hotel by 1989. The prime concern of the El Pomar Foundation trustees is to realize the top dollar value for the BROADMOOR Hotel and to continue and expand the charitable activities of the El Pomar Foundation.

The fact is The BROADMOOR is one of a kind and the type of institution which has a relatively small sale market. There is every indication there are organizations which do have an interest in purchasing the Hotel and are aware of the divestiture requirements. This has placed potential purchasers in the sound business position of waiting for the approach of 1989 so El Pomar Foundation will be forced to bargain for sale. As previously indicated, the Hotel is not a readily marketable entity. In fact, it is sui generis. This is a unique situation, for a potential purchasing entity would be not only buying the BROADMOOR Hotel, but the many surrounding improvements including the BROADMOOR World Arena, BROADMOOR ski area, three eighteen hole golf courses, and numerous other associated and related activities. In addition, the BROADMOOR Hotel has nearly 2,000 acres of land adjacent to the Hotel which, because of development in the Colorado Springs area, are being sold to prospective developers in small parcels. The first sale of land was made in October, 1981. These sales will continue to increase the net income of BROADMOOR Hotel and the dividends received by the El Pomar Foundation, which in turn are devoted to charitable purposes.

The management which has been hired by the Foundation to operate the BROADMOOR Hotel has certainly placed the interests of the Pikes Peak region and the State of Colorado at the forefront. The BROADMOOR Hotel has been a good citizen of the community. There are many in the community who feel the uniqueness of this situation, and local ownership, are very good reasons for continued ownership by the El Pomar Foundation.

The abusive factors that led to the foundation legislation in 1969 have been corrected. The legislation itself was a catalyst which forced many foundations to comply and to continue to strive to serve the public better. As has been previously pointed out, one of the prime reasons for the 4943 provision, the operation of business entities free from the influence of the grantors of the foundation or their lineal heirs, has been met. It should be stressed that the BROADMOOR Hotel operates under exactly the same tax burdens as a privately owned hotel, and is not placed in a posture where it is in unfair competition with other privately owned entities.

It is for the foregoing reasons the El Pomar Foundation respectfully requests your positive consideration.

EL POMAR FOUNDATION

Grants 1937 to January 1, 1983

Education:	
Higher Education:	
The Colorado College	$ 9,546,312
The Colorado College (Minority and Handicapped scholarships)	1,212,850
Air Force Academy Foundation	1,030,000
Colorado Women's College	652,735
University of Denver	4,706,195
Other Private and State Colleges	624,691
Secondary Education:	
Colorado Outward Bound	610,000
Chicano Education Project	115,000
Fountain Valley School	3,560,215
Miscellaneous as a group	2,151,685
Health:	
Penrose Hospital and Cancer Research	12,823,580
Other Hospitals	1,315,882
Miscellaneous as a group	414,865
Humanities:	
Central City Opera House Association	449,250
Cheyenne Mountain Museum & Zoological Society	9,735,599
Colorado Springs Fine Arts Center	2,032,088
Colorado Springs Symphony	264,200
Citizens for a Theatre Auditorium	3,100,000
Miscellaneous as a group	1,390,856
Religion:	
Miscellaneous as a group	2,256,615
Resources and environment:	
City of Colorado Springs Library	2,203,872
Garden of the Gods Land Purchase	250,000
Miscellaneous as a group	545,000
Welfare:	
Boys Club Association	508,278
Boy & Girl Scouts	430,480
United Way	1,806,186
YMCA-YWCA	2,050,000
Chins Up	38,000
Workout Limited	55,000
Domestic Violence	190,000
Brockhurst Boys Ranch	140,000
Y/JA	703,000
Silver Key Senior Services	213,425
Miscellaneous as a group	1,115,498
Other:	
United States Olympic Committee	1,050,000
Miscellaneous as a group	2,749,249
Total grants to January 1, 1983	72,040,606

(Appendix A)

EL POMAR FOUNDATION - *Summary of income and grants from December 31, 1937 through December 31, 1982*

Year	Revenues	Expenses	Federal Excise Tax	Excess of rev. over expenses	Grants	Balance
12/16-31, 1937	64 650	7		64 643	84 474	(19 831)
1938		6 064		(6 064)	55 254	(61 318)
1939	13 425	6 288		7 137	74 700	(67 563)
1940	365 675	6 745		358 930	100 933	257 997
1941	323 950	6 823		317 127	403 697	(86 570)
1942	347 235	12 569		334 666	248 250	86 416
1943	405 369	23 698		381 671	199 842	181 829
1944	422 116	36 647		385 469	316 611	68 858
1945	473 592	14 814		458 778	282 985	175 793
1946	426 129	10 241		415 888	466 371	(50 483)
1947	438 343	16 519		421 824	366 982	54 842
1948	454 509	12 132		442 377	454 112	(11 735)
1949	452 590	11 159		441 431	693 150	(251 719)
1950	469 392	10 380		459 012	413 945	45 067
1951	470 997	10 983		460 014	540 204	(80 190)
1952	473 872	9 985		463 887	534 532	(70 645)
1953	573 689	10 481		563 208	725 855	(162 647)
1954	1 429 630	11 081		1 418 549	563 224	855 325
1955	1 982 573	16 995		1 971 578	536 961	1 434 617
1956	1 188 831	10 757		1 178 074	1 288 246	(110 172)
1957	1 152 420	11 648		1 140 772	1 569 697	(428 925)
1958	1 032 179	11 797		1 020 382	1 895 458	(875 076)
1959	1 162 431	14 077		1 148 354	1 502 715	(354 361)
1960	1 099 459	14 483		1 084 976	916 312	168 664
1961	1 107 373	14 872		1 092 501	1 169 770	(77 269)
1962	1 110 248	11 123		1 099 125	1 501 597	(402 472)
1963	1 263 162	9 487		1 253 675	1 465 215	(211 560)
1964	918 929	9 524		909 405	920 398	(10 993)
1965	1 686 301	10 834		1 675 467	1 404 550	270 917
1966	1 872 239	9 902		1 862 337	1 166 266	696 071
1967	1 517 824	8 786		1 509 038	1 558 009	(48 971)
1968	1 520 504	9 239		1 511 265	2 394 193	(882 928)
1969	3 020 870	14 754		3 006 1[illegible]	3 071 317	(65 201)
1970	3 223 159	14 334	128 926	3 079 899	3 219 560	(139 661)
1971	2 697 739	22 473	113 987	2 561 279	2 670 676	(109 397)
1972	3 009 599	18 907	132 276	2 858 416	4 816 968	(1 958 552)
1973	3 128 228	20 991	125 057	2 982 180	3 122 666	(140 486)
1974	3 460 425	21 115	138 345	3 300 965	3 386 353	(85 388)
1975	3 405 868	21 738	136 163	3 247 967	3 108 275	139 692
1976	3 546 846	33 107	151 186	3 362 553	2 959 996	402 557
1977	3 963 095	44 620	135 973	3 782 502	1 967 287	1 815 215
1978	3 374 607	47 180	71 622	3 255 805	3 283 446	(27 641)
1979	3 559 454	65 334	67 925	3 426 195	3 419 948	6 247
1980	3 964 323	63 825	67 854	3 832 644	3 898 684	(66 040)
1981	4 380 892	71 569	113 848	4 195 475	3 597 080	598 395
1982	4 097 487	111 577	81 554	3 904 356	3 855 717	48 639
	75 052 228	945 664	1 464 716	72 641 848	72 192 481	449 367

APPENDIX B

STATEMENT OF WILLIAM MORRIS, ESQ., REID & DRIEST, WASHINGTON, D.C., APPEARING ON BEHALF OF THE ALTMAN FOUNDATION

Mr. **Morris**. That is correct, Mr. Chairman. My name is William Morris. I am an attorney with the law firm of Reid and Driest, with offices in Washington and New York City, and I am appearing this afternoon on behalf of the Altman Foundation.

With your position, I would like to submit a full statement for the record, which details our entire presentation.

Senator **Armstrong**. Of course. It will be included in its entirety in the record.

[The prepared statement of John S. Burke follows:]

TESTIMONY OF JOHN S. BURKE,
PRESIDENT OF
THE ALTMAN FOUNDATION
BEFORE THE
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
COMMITTEEE ON FINANCE
U.S. SENATE

AUGUST 1, 1983

MY NAME IS JOHN S. BURKE. I AM THE PRESIDENT OF THE ALTMAN FOUNDATION AND CHAIRMAN OF THE BOARD OF B. ALTMAN & CO., THE NEW YORK BASED RETAIL DEPARTMENT STORE GROUP. I HAVE BEEN EMPLOYED BY B. ALTMAN & CO. SINCE 1946 AND HAVE BEEN ASSOCIATED WITH THE ALTMAN FOUNDATION SINCE 1948.

THE ALTMAN FOUNDATION WAS FORMED IN 1913 BY BENJAMIN ALTMAN WITHOUT ANY INCOME TAX OR ESTATE TAX ADVANTAGE TO HIM. HIS FOUNDATION WAS PURE PHILANTHROPY. THE FOUNDATION, A NEW YORK NON-PROFIT CORPORATION WITH AN OFFICE IN NEW YORK CITY, CARRIES OUT ITS CHARITABLE PURPOSES THROUGH GRANTS TO CULTURAL, EDUCATIONAL AND RELIGIOUS ORGANIZATIONS. THESE GRANTS HAVE BEEN MADE, IN THE MAIN, TO SOCIAL WELFARE ORGANIZATIONS, HOSPITALS, UNIVERSITIES AND LIBRARIES, YOUTH GROUPS AND NEIGHBORHOOD ASSOCIATIONS.

WHEN MR. ALTMAN DIED IN 1913 WITHOUT A FAMILY HE LEFT TWO IMPORTANT LEGACIES TO THE PEOPLE OF NEW YORK-- HIS FAMOUS ART COLLECTION WENT TO THE METROPOLITAN MUSEUM OF ART. HIS ENTIRE INTEREST IN THE STORE WENT TO THE ALTMAN FOUNDATION FOR THE BENEFIT OF THE PEOPLE OF NEW YORK AND FOR THE BENEFIT OF HIS EMPLOYEES.

FOR MORE THAN THREE GENERATIONS, THE FOUNDATION HAS TOUCHED THE LIVES OF MILLIONS OF NEW YORKERS. IT HAS GIVEN MORE THAN $24 MILLION TO NEARLY 1,000 DIFFERENT CHARITABLE ORGANIZATIONS OPERATING IN NEW YORK. SOME OF THE MAJOR BENEFICIARIES INCLUDE THE FEDERATION OF JEWISH PHILANTHROPIES, CATHOLIC CHARITIES OF THE ARCHDIOCESE OF NEW YORK, FEDERATION OF PROTESTANT WELFARE AGENCIES, INC., NEW YORK UNIVERSITY, FORDHAM UNIVERSITY, ST. LUKE'S HOSPITAL, ST. VINCENT'S HOSPITAL, THE URBAN LEAGUE, THE SALVATION ARMY, THE BOY SCOUTS AND GIRL SCOUTS, THE LENOX HILL NEIGHBORHOOD ASSOCIATION, THE NEW YORK URBAN COALITION, CASITA MARIA, INC., AND THE NEW YORK PUBLIC LIBRARY.

GRANTS FROM THE FOUNDATION HAVE BEEN AS SMALL AS $5 (PRIMARILY IN ITS EARLIEST YEARS OF OPERATION) AND AS LARGE AS $100,000. IN 1982 WE DISTRIBUTED OUR ENTIRE NET INCOME OF $790,500. FOR YEARS WE HAVE ATTEMPTED TO BE CONSISTENT SUPPORTERS OF A RANGE OF RECOGNIZED AND EFFECTIVE CHARITABLE ORGANIZATIONS SINCE WE KNOW THEY MUST BUDGET IN ADVANCE IN ORDER TO PLAN THEIR ACTIVITIES.

THE FOUNDATION, OPERATED BY A BOARD OF SIX TRUSTEES, INCURS MINIMAL OPERATING COSTS. THE TOTAL EXPENSES OF THE FOUNDATION (INCLUDING FEDERAL EXCISE TAX) AMOUNT TO ABOUT $70,000 PER YEAR INCLUDING $20,000 CONNECTED WITH THE PREPARATION OF ANNUAL FINANCIAL STATEMENTS AND FORMS FILED WITH THE IRS. ALL FUNDS RECEIVED ARE DISTRIBUTED EACH YEAR TO CHARITIES. IN THE PAST DECADE WE HAVE DISTRIBUTED FUNDS IN EXCESS OF NET INVESTMENT INCOME IN SIX SEPARATE YEARS.

THE PRIMARY GIFT OF STOCK TO THE FOUNDATION WAS MADE BY BENJAMIN ALTMAN PRIOR TO THE ENACTMENT OF THE FIRST FEDERAL ESTATE AND GIFT TAX PROVISIONS AND WAS MADE WITHOUT TAX MOTIVATION OR ADVANTAGE. UNDER SECTION 4943 THE FOUNDATION IS REQUIRED TO DISPOSE OF APPROXIMATELY 50% OF ITS STOCK IN B. ALTMAN & CO. BY MAY 25, 1984. SIGNIFICANT ATTEMPTS HAVE BEEN MADE TO ARRANGE THE REQUIRED SALE; HOWEVER, DISPOSITION EFFORTS HAVE BEEN ADVERSELY AFFECTED BY MARKET CONDITIONS.

SINCE 1969, THE ALTMAN FOUNDATION HAS ENGAGED IN SERIOUS DISCUSSIONS WITH POTENTIAL PURCHASERS OF B. ALTMAN & CO. THESE EFFORTS HAVE BEEN UNSUCCESSFUL. POTENTIAL PURCHASERS, AWARE OF THE FOUNDATION'S NEED TO SELL THE BUSINESS HAVE MADE OFFERS WHICH SIGNIFICANTLY UNDERVALUE THE ASSETS AND OPERATING WORTH OF B. ALTMAN & CO. AS FIDUCIARIES, THE TRUSTEES COULD NOT ACCEPT THE TERMS AND CONDITIONS OF THE OFFERS.

CONSEQUENTLY, WE STRONGLY SUPPORT THE CALL FOR MODIFICATION AND/OR REPEAL OF SECTION 4943. SPECIFICALLY, WE URGE YOU TO APPROVE LEGISLATION WHICH CONSIDERS THE SPECIAL AND UNIQUE CIRCUMSTANCES OF THE ALTMAN FOUNDATION.

THE UNDERLYING RATIONALE FOR SECTION 4943 IS TO ENSURE THAT FUNDS SET ASIDE FOR PHILANTHROPY, ENCOURAGED BY INCOME AND ESTATE TAX DEDUCTIONS AND INCOME TAX EXEMPTIONS, ACTUALLY ARE DISBURSED TO BENEFIT THE PUBLIC. IN THE CASE OF THE ALTMAN FOUNDATION FEDERAL INCOME AND ESTATE TAX DEDUCTIONS WERE NOT A MOTIVATING FACTOR. BENJAMIN ALTMAN WAS FAR AHEAD OF HIS CONTEMPORARIES IN HIS CONCERNS FOR CHARITY. SINCE 1913, HIS

INTENTIONS HAVE BEEN FAITHFULLY FOLLOWED BY ALL THOSE WHO HAVE BEEN TEMPORARILY VESTED WITH RESPONSIBILITY FOR THE OPERATION OF HIS FOUNDATION.

ACCORDINGLY, WE BELIEVE AN EXEMPTION FROM THE "EXCESS BUSINESS HOLDINGS" PROVISIONS SHOULD BE PROVIDED FOR CERTAIN FOUNDATIONS; THOSE WHERE NO FEDERAL INCOME OR ESTATE TAX DEDUCTION WAS CLAIMED FOR THE VALUE OF THE STOCK ORIGINALLY TRANSFERRED. THE DETAILS OF THIS PROPOSAL ARE SET FORTH IN MY PREPARED STATEMENT SUBMITTED FOR THE RECORD.

MR. CHAIRMAN, WE ARE NOT UNMINDFUL THAT CONGRESS MAY WISH TO ADDRESS THE ISSUE OF "EXCESS BUSINESS HOLDINGS" ON A BROADER BASIS. WE BELIEVE IT WOULD BE APPROPRIATE TO CONSIDER MODIFICATIONS TO ENSURE MAXIMUM CHARITABLE DISTRIBUTIONS AND INDEPENDENT OPERATION OF FOUNDATIONS AND THE BUSINESSES THEY OWN. WE SUPPORT BROADER PUBLIC DISTRIBUTION OF INFORMATION ABOUT FOUNDATIONS CHARITABLE WORK. WE EXPECT TO BE FULLY ACCOUNTABLE FOR OUR WORK ON BEHALF OF THE FOUNDATION. WE ARE PREPARED TO WORK WITH THE APPROPRIATE COMMITTEE STAFFS AND THE TREASURY DEPARTMENT TO DEVELOP THE NECESSARY RULES AND SAFEGUARDS.

THE ALTMAN FOUNDATION IS FACED WITH A RAPIDLY APPROACHING DEADLINE UNDER SECTION 4943. UNLESS A SET OF GENERAL RULES CAN BE DEVISED AND APPROVED SOON, THE FOUNDATION WILL BE FORCED TO DISPOSE OF ABOUT HALF OF ITS HOLDINGS IN B. ALTMAN & CO. IN LESS THAN ONE YEAR. THIS COULD RESULT IN A "FIRE SALE" OF THE B. ALTMAN & CO. STOCK NOW HELD BY THE FOUNDATION.

ACCORDINGLY, WE URGE CONGRESS TO REVISE SECTION 4943(c)(4)(B)(i) TO PERMIT THOSE PRIVATE FOUNDATIONS WHICH, TOGETHER WITH ALL DISQUALIFIED PERSONS, HELD MORE THAN 95% OF THE VOTING STOCK OF A BUSINESS ENTERPRISE ON MAY 26, 1969, TO BE PERMITTED TO RETAIN THEIR EXCESS BUSINESS HOLDINGS UNTIL MAY 25, 1989. THIS WOULD PROVIDE THE ALTMAN FOUNDATION AS WELL AS OTHER FOUNDATIONS WITH AN ADDITIONAL FIVE YEARS IN WHICH TO DISPOSE OF THEIR EXCESS BUSINESS HOLDINGS. THIS PROPOSED CHANGE WOULD ESTABLISH A CONSISTENT RULE FOR DETERMINING WHETHER A PRIVATE FOUNDATION SHOULD HAVE 15 OR 20 YEARS TO DISPOSE OF PART OF ITS HOLDINGS UNDER SECTION 4943(c)(4)(B)(i) OR (ii).

IN THE ALTERNATIVE, WE BELIEVE CONGRESS SHOULD APPROVE AN ACROSS-THE-BOARD STATUTORY 5 YEAR EXTENSION OF TIME FOR ALL PRIVATE FOUNDATIONS REQUIRED TO DISPOSE OF EXCESS BUSINESS HOLDINGS.

WE ASK THIS SUBCOMMITTEE AND THE FULL COMMITTEE ON FINANCE TO REVISE SECTION 4943 OF THE CODE AS QUICKLY AS POSSIBLE. THANK YOU FOR THIS OPPORTUNITY TO APPEAR BEFORE THE SUBCOMMITTEE TODAY.

Mr. MORRIS. Very briefly, I can summarize by telling you that the Altman Foundation was created by Benjamin Altman in 1913 prior to the imposition of the first Federal, State and gift tax provision, and it was created with no tax benefits or contributions to the foundation. The foundation is located in New York City and carries out its charitable purposes through grants to cultural, educational, and religious organizations, and these have been, in the main, to social welfare organizations, hospitals, universities, libraries, youth groups and neighborhood associations.

For more than three generations, the foundation has given more than $24 million to nearly a thousand different charitable organizations operating in New York. Grants from the foundation have been as small as $5 and as large as $100,000. In 1982, we distributed our entire net income of over $790,000. The foundation is operated by a board of six trustees and it incurs minimal operating expenses. The total expenses of the foundation amount to about $70,000 per year, including approximately $20,000 connected with the preparation of its annual financial statements filed with the Internal Revenue Service, and approximately another $20,000, or just under $20,000, to the Federal excise tax on net investment income.

In the past decade we have distributed funds in excess of net investment income in 6 separate years. The primary gift to the foundation was made by Benjamin Altman, as I indicated, prior to the enactment of the first Federal, State and gift tax provisions. Since 1969, the foundation has engaged in serious discussions with potential purchasers of B. Altman and Co. and the efforts have been unsuccessful. B. Altman and Co. is a retail department store located in New York City. Much like the Broadmoor Hotel, it is a historic institution in the city of New York.

We strongly support the call for a modification and/or repeal of section 4943. We also strongly support your legislation, S. 1464. We would, of course, like it modified slightly to include an entity similar to the Altman Foundation. And, in fact, the Committee on Finance during the Ninety-seventh Congress approved a series of provisions as amendments to H.R. 4577. One of those provisions not only included the El Pomar Foundation, another included the Altman Foundation. And it is that legislation that we seek as well. In our full statement for the record there are some technical modifications that we also would request the committee to consider as well.

We are faced with a very rapidly approaching deadline under section 4943. We must divest of the stock of B. Altman and Co. unless existing law is changed on or before May 25, 1984. And, therefore, the relief that we request would be needed promptly. Thank you very much, Mr. Chairman, for this opportunity to briefly outline our situation. And I would be happy to answer any questions that you might have.

Senator ARMSTRONG. Thank you, Mr. Morris. Senator Long, did you have any observations or statement or any questions for the panel?

Senator LONG. No questions, Mr. Chairman. I have, down through the years, supported at least one of these institutions.

Senator ARMSTRONG. I appreciate that. Needless to say, I am grateful for that observation.

Gentlemen, because I am really very familiar with the issue, and I think other members of the Finance Committee are also familiar, in general, with the Altman issue, and in detail at least with the issues in the *El Pomar* case, since the committee recommended and the Senate did adopt this proposal in 1982 and on at least one previous occasion. I don't think there is really any need to draw out the discussion today. But I would ask each of you one question and then ask your cooperation in one task. My question is this, for Mr. Hybl and for Mr. Morris if he cares to respond: In the discussion this morning, the Treasury Secretary representative pointed out that the original legislation in 1969 was occasioned by some substantial abuses that were then occurring among foundations. He referred specifically—and I am now quoting—to self-dealing between foundations and donors, undue delay in the delivery of benefits to charity, extensive foundation involvement in businesses resulting in noncharitable use of charitable assets, family use of foundations to control corporate and other property, and financial transactions unrelated to charitable functions. My belief in what I assured the Treasury Department was that none of those elements are present in the case of El Pomar. And I just wanted to inquire if there is any reason I should be uncomfortable with that statement. I am not aware that there has ever been any allegations of abuses of this type. Is that correct?

Mr. HYBL. Mr. Chairman, you are correct, there have been no violations. There are certainly no instances that I am aware of in my association with the foundation. I will submit for the record a certified letter from Arthur Young and Co. indicating, since 1969, there have been no violations involved with this particular act.

Senator ARMSTRONG. I appreciate that.

[The letter follows:]

ARTHUR YOUNG

ARTHUR YOUNG & COMPANY
1670 BROADWAY, SUITE 2500
DENVER, COLORADO 80202

(303) 831-9500 TELEX 45-4423

April 13, 1983

Mr. William J. Hybl
El Pomar Foundation
P. O. Box 64
Colorado Springs, Colorado 80901

Dear Mr. Hybl:

Our firm has been the accountants and auditors for the El Pomar Foundation (Foundation) for many years before the enactment of P.L. 91-172 (1969 Tax Reform Act) and for all years since that Act. Under the 1969 Tax Reform Act, the Foundation is classified as a Private Foundation and as such is subject to Sections 4940 through 4946 of the Internal Revenue Code.

We have assisted the Foundation with the annual preparation of the various returns and reports to be filed, such as Forms 990-AR and 990-PF, for all the years since the 1969 Tax Reform Act provisions were enacted. To the best of our knowledge and belief, the Foundation has fully complied with the provisions of Section 4940 through 4946 for the years 1969 through 1982 and has not paid or been required to pay any of the taxes or so-called "penalty payments" provided in these Sections other than, of course, the Excise Tax based on investment income provided in Section 4940.

Very truly yours,

ARTHUR YOUNG & COMPANY

Harold D Hein

Harold D. Hein

HDH/lkd

Senator **Armstrong**. I also want to refer to one other question that was raised by the Department. Again, I quote, a business that is owned by a tax exempt entity often has a competitive advantage over a similar business owned by taxable persons. Would that apply in the case of El Pomar and the ownership of the Broadmoor?

Mr. **Hybl**. No; it certainly would not apply, Mr. Chairman, in that the Broadmoor Hotel does pay full taxes like any other taxable entity. The trustees of the El Pomar Foundation have viewed investment in the Broadmoor Hotel similar to the way that they would look at IBM, Zerox or any other profit making entity, expecting a full and fair return.

Senator **Armstrong**. Thank you, Mr. Hybl.

Mr. Morris, don't feel obligated to comment on those questions because I think they are new to you at least, but if you would care to we would welcome your response.

Mr. **Morris**. I believe that I can respond just as Mr. Hybl has, that certainly since 1969 there has been no hint that the Altman Foundation has been involved in any transaction that would involve any of the issues raised by the Treasury Department. And similar to Mr. Hybl's response with respect to unfair competitive advantage, the foundation which owns B. Altman and Co. owns a company which is subject to all State, local and Federal taxes just as any other taxable entity, and does not enjoy any particular tax favored status.

Senator **Armstrong**. I appreciate that. And I would invite each of you if you would like to review at your leisure the statements submitted by the Treasury Department, and if you have any written thoughts that you would like to add. Our hope is that the Senate will adopt this legislation, whether the Treasury Department has a different thought later or not. But it will be helpful if we can answer these questions point by point. And I noted—I think neither of you were in the room this morning—but I noted that in recent years on only two occasions has the Treasury Department testified in favor of legislation. It is their norm to come in and testify against anything that is proposed, and rightfully so in a sense. It is their job to, in effect, defend the status quo at least in part, and they have done that. But whatever answers you have on the issues they have raised we would be glad to have.

Unless Senator Long has something else, I think that takes care of what we need to do on S. 1464.

Mr. **Hybl**. Thank you, Mr. Chairman.

Senator **Armstrong**. Thank you, gentlemen.

We now come to S. 1549, which would permit individual retirement accounts, qualified retirement trusts, and certain educational organizations to invest in working interests in oil and gas properties without incurring unrelated business taxable income.

STATEMENTS ON INTRODUCED BILLS AND JOINT RESOLUTIONS UPDATING THE UNRELATED BUSINESS INCOME TAX

By Mr. Armstrong, Long, Durenberger, Wallop, Grassley, Symms, Bentsen, Baucus, Boren, Pryor.

S. 1549. A bill to amend the Internal Revenue Code of 1954 to permit individual retirement accounts, qualified retirement trusts and certain educational organizations to invest in working interests in oil and gas properties without incurring unrelated business taxable income.

UPDATING THE UNRELATED BUSINESS INCOME TAX

Mr. ARMSTRONG. Mr. President, legislation I have introduced with Senators Durenberger, Long, Wallop, Grassley, Symms, Bentsen, Baucus, Boren and Pryor could, once enacted, increase profits earned by pension plans and college endowments, at the same time, infuse new and badly needed capital in domestic oil production.

This legislation is nearly identical to H.R. 7217, a House bill introduced by Representatives Jenkins, Matsui, Gephardt, and Frenzel, and is simple in concept. It permits pension plans and college endowments to treat, for tax purposes, income from oil and gas production exactly like income earned from stocks, bonds, and royalties. Once enacted, an additional investment pool of more than $500 billion would be available for investment in oil and gas production, and at the same time give pensions and endowments possibly higher rates of return on their holdings.

Some background on current tax law will explain the need for this legislation. Most college endowments and private pension plans are granted tax exempt status. Even if they are tax exempt, some sources of income received by pensions and endowments can, under current law be taxable. For Federal tax purposes, there are two sources of income—passive and unrelated business—for pensions and endowments. Passive income—not taxed—usually is interest and dividends earned on stocks, bonds, and royalties. Unrelated business is income taxed at corporate rates because, in theory, the income is derived from a business or investment not related to the purpose of the pension or endowment for which it received its tax exempt status.

This tax theory is 30 years old, and it makes sense. It seeks to eliminate unfair competition to taxpaying businesses by taxing their competitors controlled by tax organizations on the same basis. For example, an endowment owning controlling interest in a manufacturing plant should be taxed on the same basis as the manufacturer's competitor.

Generally, endowment and pension income that is exempted from the unrelated business income—or UBTI—will not be taxed. The problem is that in the past 30 years there has been precious little updating of UBTI. The result is not surprising. Changing economic conditions and new investment opportunities have somewhat outdated the unrelated business income tax. For example, it used to be that stocks and bonds enjoyed high rates of return and tax exempt organizations invested in them heavily. But the past 10 years have found the traditional equities—stocks and bonds—have been hard pressed to maintain an economic rate of return.

Simultaneously, however, direct investments in oil and gas producing properties have proved to be low risk, consistently performing assets that have brought yields outpacing inflation rates. Solomon Bros. reports that annual rates of return for oil assets have outpaced return rates on real estate, stocks, gold, and silver.

But the problem is that the current UBTI taxes earnings from most oil and gas production holdings of pension plans and private investments. The inevitable result is that pension and endowment trustees do not invest in oil and gas production and are foreclosed from higher investment returns than are available from stocks and bonds. Concurrently, oil and gas producers lose access from a large investment pool, estimated to be about $500 billion.

The bill I am introducing today is the solution to this problem. This bill permits pension and college endowments to invest through limited partnerships in working interests in oil and gas properties without being subject to the unrelated business income tax. This legislation is consistent with the underlying theory of the UBTI because it permits these funds to only passively invest in oil and gas production * * * meaning that the pension and endowment trustees cannot take part in the control of the business of producing oil and gas.

The bill has important safeguards that should make this bill noncontroversial:

First. Pension plans and endowments can only invest as a passive owner in a limited partnership, meaning they cannot exercise control in business decisions. In fact, limited partners exercise even less control over business decisions than stockholders do.

Second. Only qualified pension funds and educational organizations, as already defined in current tax laws, are covered under this legislation.

Third. These funds can only invest in working interests in oil and gas properties, meaning they must pay a share of the development and operating costs to receive a share of income. The definition of working interest is the same now used in current law.

Fourth. Pension plans and endowments will receive no benefit from income tax credits and deductions available to taxable limited partners. The bill also precludes allocations of these deductions and credits to taxable partners.

Fifth. Pensions and endowments will not receive exempt income from working interests held by a limited partnership if either organization is related to the general partner.

There are a number of reasons why this bill should pass, and soon. First, the bill has no revenue loss since investments in oil and gas production will only augment investments otherwise made in currently tax-exempt investments.

Second, the bill encourages portfolio diversification by pension plans and endowments that control nearly $500 billion.

Third, this bill offers the promise of higher rates of return than these pensions and endowments now presently receive.

Fourth, it will infuse new and badly needed capital in oil and gas production without raising energy prices. In fact, capital expenditures this year in oil and gas activity has decreased 35 percent this year.

Fifth, the legislation is consistent with the underlying theory governing unrelated business taxable income.

Sixth, this legislation corrects an anomaly in the current UBTI law. Currently, pensions and endowments can receive tax free income from oil royalties—simply investments in oil and gas activities where the investor pays none of the development costs—but cannot receive tax free income from working interests in oil producing properties. In both types of oil investments—royalty and working interest programs—investors are passive * * * exercising no control over business decisions. Thus, partnerships owning working interests should be subject to the same tax rules as are applied to oil royalties.

This legislation is nearly identical to legislation I introduced in 1982. A number of important provisions have been added to address issues raised since the bill was first introduced. These provisions, about four in number address concerns raised about partnership allocation, abusive sale-leaseback arrangements, and the use of debt in buying shares in a limited partnership.

I welcome further consideration of this bill.

Senator **Armstrong**. We welcome a panel consisting of Dwight Moorhead, vice president of Petro-Lewis from Denver; I. Jon Brumley, president of the Southland Royalty Co. of Fort Worth, Tex.; Paul F. Overgaard, vice president, Independent Service Company, of Albert Lea, Minn.; and Bert H. Murphy, of the Murphy Energy Corp., Roswell, N. Mex. Gentlemen, would you come forward, and we will be pleased to have your statements.

Mr. Moorhead, why don't you begin. I know that you have a statement and we would be glad to have that. And it is possible that we will also have some questions as we go on.

STATEMENT OF DWIGHT MOORHEAD, VICE CHAIRMAN, PETRO-LEWIS CORP., DENVER, COLO.

Mr. **Moorhead**. Thank you, Mr. Chairman. I first have to wonder if anyone has taken the opportunity, with the permission of the committee, to wish you Happy Colorado Day.

It is appropriate to note that I have previously submitted written testimony, and I would ask at this time that it be entered into the record of these proceedings. Further, Bert Murphy, as a result of an unexpected family situation, is unable to attend today, but has asked me to request that his written testimony, which he had intended and expected to present today, be included in the record.

Further, Ed Cain, from Apache Corp., is at this table, with the permission of the committee.

[The prepared statements of Dwight Moorhead and Bert Murphy follow:]

TESTIMONY OF DWIGHT C. MOORHEAD
VICE CHAIRMAN OF THE BOARD
PETRO-LEWIS CORPORATION
ON S. 1549
BEFORE THE
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
COMMITTEE ON FINANCE
UNITED STATES SENATE

Introduction

Mr. Chairman, my name is Dwight Moorhead. I am Vice Chairman of the Board of Petro-Lewis Corporation. Petro-Lewis is an independent producer of oil and gas headquartered in Denver, Colorado. Petro-Lewis acts as the principal operating entity for a large number of limited partnerships, which own oil and gas producing properties located throughout the United States. Petro-Lewis serves over 145,000 limited partners and has five regional offices in Houston, Texas; Oklahoma City, Oklahoma; Billings, Montana; Lubbock, Texas; and Bakersfield, California. About 43% of our 2,127 employees work in these regional offices. At the present time, Petro-Lewis manages daily production of 62,200 barrels of oil and 243.6 million cubic feet of natural gas.

Petro-Lewis is not a traditional exploration and production company. The company acquires and manages oil and gas properties on behalf of investors. The investment concept of the oil income program was pioneered by Petro-Lewis in 1970. Each month, a limited partnership is formed that permits investors to acquire an interest in domestic oil and gas properties which are already producing, and Petro-Lewis manages the partnerships' activities as general partner. The oil and gas income program functions very much like mutual fund holding stocks or bonds in that it is designed to provide cash flow and competitive market yield and to offer liquidity. Investors have found our oil income program an attractive investment vehicle and thus have invested about $1.9 billion (February 1983 data) of their funds in our program. These funds have financed the acquisition of more than $3.1 billion (Feburary 1983 data) worth of producing properties, which Petro-Lewis presently manages. The average rate of return on our program is 17.2%, assuming that an investor made equal investments in each monthly partnership from October, 1970, through October, 1982, and that all investments were liquidated on December 31, 1982. This compares very favorably with other investments like stocks and bonds and Treasury bills. For example, from 1970 to 1982, the Standard & Poor's 500 Stock Index returned an average 9.5% per year; the Salomon Brothers Bond Index returned 8.1% per year; and T-bills returned an average 7.8% per year. Current oil income program yields are also attractive, compared to municipal bonds (8-9%), and corporate bonds (12-13.5%) -- 20% on our PLPC I partnership, 9% on our PLPC II partnership, and 12-14% on the more recently formed oil income partnerships (since November 1980).

In addition, investors recognize the considerable potential for improvements in both the value of their oil and gas producing properties and in their income stream. Such potential stems from price increases on oil and gas sales and from changes in the amount of reserves expected to be recoverable from their properties. Therefore, the direct investment in oil and gas producing properties through the limited partnership vehicle has significant inflation-hedging potential as well as excellent cash flow characteristics. The same cannot always be said for typical corporate stocks and bonds. At least two public utilities, the traditional investment for widows and orphans, have either suspended dividends or defaulted on interest payments of their securities in the 1970-83 period.

Currently, about 90% of our investors are individuals and trusts representing individuals, who must meet net worth requirements prior to investment. Our prospectus is filed with and approved by the SEC and applicable State regulatory agencies. The average initial investment in each partnership is about $8,500. Cash distributions can be automatically reinvested at the option of the investor and typically produce about $4,800 in additional investment for the average account. Our investors expect a steady cash flow and the opportunity for growth in the value of their investment through price appreciation of oil and gas or from the ability to recover more hydrocarbons from their properties. They do not expect a tax shelter, although they receive modest tax benefits.

Summary Of Our Position

Petro-Lewis Corporation strongly supports S. 1549. The bill will provide the independent domestic oil industry with access to another source of domestic capital with which to fund the development and operation of our hydrocarbon resource base. The tax code currently discourages qualified pension funds and educational organizations from considering an investment in oil and gas interests that bear developmental obligations (i.e., working interests) by taxing the income from such investments. However, exemptions are provided for income from oil and gas royalties, net profits interests, production payments, and corporate stocks and bonds because they are considered passive sources of income. We believe that an exemption from the unrelated business income tax for working interest income from oil and gas limited partnerships would comport with the current exemptions provided for other forms of passive oil income. By law, limited partners do not have control over daily management decisions of the partnership. Moreover, such an exemption would not have detrimental effect on Federal revenues since the Treasury currently receives little (if any) from this source.

In the long run, we expect that a well-diversified pension portfolio would invest a small portion of its assets in oil and gas limited partnership interests. Sophisticated money managers would evaluate this investment according to its risk/reward characteristics and its ability to help them diversify their holdings. Finally, S. 1549 would encourage the giving of limited partnership interests in oil and gas properties to colleges and universities, which would benefit from both the steady cash flow and the potential for capital appreciation. Currently, such educational institutions often liquidate such gifts of property at distress prices in order to avoid jeopardizing their tax-exempt status.

Potential Source of New Capital

Qualified pension funds and educational organizations have a wide variety of passive investments from which to choose, including corporate bonds and stocks, government securities, real estate properties, mortgages, foreign stocks and bonds denominated in either U.S. dollars or other currencies, venture capital-related securities, precious metals, art, oil and gas royalties, net profits interests, and production payments.

It is our belief that limited partnership interests in oil and gas income programs should also be available for investment by such funds and organizations. Such limited partnership interests have investment qualities similar to royalties, net profits interests, and production payments. Moreover, the managers of tax-exempt funds are fully capable of choosing the appropriate passive oil and gas investments for their funds. Indeed, those managers are fiduciaries held to high standards of expertise and prudence by Federal and State law.

Our experience indicates that limited partnership interests in oil and gas income programs will be excellent, safe investments for tax-exempt funds. Over the past 13 years, for example, Petro-Lewis Corporation's oil and gas income program returned 17.2%, while the Standard & Poor's 500 Stock Index average rate of return was 9.5%, the Salomon Brothers Bond Index returned 8.1%, and Treasury bills returned 7.8%. Real estate earned more than 9.5% per year. Similarly, international equities did not do as well as Petro-Lewis Corporation's Oil and Gas Income Program. Yet, because the income from such equities is not subject to the tax on unrelated business income, more than $10 billion of U.S. pension funds were invested overseas and thus subject to exchange rate risk, business risk, and foreign country risk.

We believe that but for the tax on unrelated business income, U.S. investment managers would have placed approximately 5% of their total portfolios in limited partnership interests in oil and gas income programs. This represents approximately $40 billion, which could be available for equity investment in the independent domestic oil industry if S. 1549 is enacted into law. These funds could help to develop and maintain our domestic hydrocarbon resource base, providing future domestic supplies of oil and gas to all U.S. consumers.

Positive Investment Characteristics

Investments in limited partnership interests like Petro-Lewis Corporation's oil and gas income programs have positive characteristics sought by investment managers. The foremost of these characteristics is a steady cash flow from the sale of oil because the U.S. consumes more oil than it produces domestically. Natural gas sales, though more susceptible to variations in demand, provide a similar steady cash flow. Even in the worst of times, 85% to 90% of all the domestic natural gas that can be produced is sold. Most other U.S. businesses experience much more cyclical cash flows. Moreover, the capital value of oil and gas producing properties normally fluctuates less than the current prices of corporate stocks or bonds, because reserve evaluations are consistent on a long-term basis with the production history of producing wells.

Oil and gas investments held in limited partnerships can be, and normally are, diversified by location, type of well, and producing information. This reduces the geographic and geological risks inherent in owning oil and gas producing properties. Independent engineering analyses are used to audit the purchase and operating decisions made by the general partners of a limited partnership. Oil and gas properties also have liquidity characteristics similar to real estate properties because there is a large and active market for oil and gas producing properties. Properties are valued according to their cash flow streams and their inherent qualities in terms of proved and potential reserves, and lenders provide mortgage funds based on current income and reserves.

S. 1549 Comports with the Exclusions from the Tax on Unrelated Business Income

The tax on unrelated business income is designed to prevent a tax-exempt organization from using its tax-exempt status to compete with taxable businesses. Exclusions from the tax are provided for income from passive investments traditionally held by tax-exempt organizations as a source of income to be used in tax-exempt activities. Numerous forms of passive investment are specifically excluded by statute, including oil and gas royalties, net profits interests, and production payments. These forms of investment are passive in nature because the investor does not control the business operations that produce the income. Although the operator of the oil or gas property may use the sales proceeds from such investments to develop the interest, tax-exemption is provided for the investor because the investor does not control such development.

Similarly, current law recognizes that a tax-exempt investor can accumulate passive income from royalties, net profits, interests, and production payments because such accumulation by reinvestment does not give the investor an unfair competitive advantage over taxable businesses. Again, because the investor does not control the operations of the oil and gas properties either directly or indirectly, those operations are actually conducted by a taxable person who pays taxes just like his competitors. Hence, the royalty, net profits interest, and production payment provide a passive form of income, which like interest or rental income does not give the investor a competitive advantage.

The obvious purpose of S. 1549 is to provide a wider selection of truly passive oil and gas investments for qualified pension funds and educational organizations. This result is achieved by treating passive investments in oil and gas properties, in the form of limited partnership interests, in the same manner that existing law now treats other forms of oil and gas investments (i.e., royalties, net profits interests, and production payments). The bill simply recognizes that dramatic changes have occurred over the past decade in the development of other forms of passive oil and gas investments and permits qualified pension funds and educational organizations to invest in passive limited partnership interests without incurring an income tax liability.

S. 1549 ensures that the limited partnership interest is truly a passive investment by prohibiting investments by tax-exempt limited partners who are related to the general partner. Thus, the bill comports with the purpose of the current exclusions for other forms of passive oil and gas income by preventing the tax-exempt investors from controlling, directly or indirectly, the business operations conducted by the general partner. Moreover, the ability of the passive investor to reinvest income to the extent not currently needed does not give the investor an unfair competitive advantage over taxable businesses because such reinvestment can only be made in similar passive forms of investment, which clearly are not anticompetitive. Indeed, S. 1549 will actually promote competition by making an additional source of capital available, on a nondiscriminatory basis, to the entire industry of taxpaying oil and gas operators.

No Negative Effect on Federal Revenues

Tax-exempt funds do not pay income tax on the income from their passive investments. S. 1549 would not change this, it would only permit the income from passive investments in oil and gas producing limited partnerships to be exempt from taxation. The mix of asset types held within a tax-exempt portfolio would change to include limited partnership interests in oil and gas income programs, but little (if any) revenues would be lost to the Treasury.

Provide Benefits To Endowments And Foundations

As the U.S. population ages, our colleges and universities face declining enrollments and financial problems in meeting their operating and fixed costs. Increasingly, they must rely on income from their endowment funds. Gifts of limited partnership interests in oil and gas producing properties, with their positive investment characteristics like steady income and potential appreciation, would be beneficial. Today such gifts are often sold as quickly as possible, often at distress prices, in order to avoid potential adverse tax consequences. Under S. 1549, colleges and universities could retain those interests as passive limited partners.

Conclusion

For all of these reasons, Petro-Lewis Corporation strongly supports S. 1549. The bill recognizes that during the past decade, dramatic changes have been made in the forms of passive oil and gas investments available for qualified pension funds and educational organizations and provides for a much needed update to the tax code to accomodate those changes. We believe that S. 1549 reflects sound tax and energy policy and should be enacted into law.

Thank you.

TESTIMONY OF BERT MURPHY
CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER
MURPHY ENERGY CORPORATION
ON S.1549
BEFORE THE SENATE FINANCE SUBCOMMITTEE
ON TAXATION AND DEBT MANAGEMENT

Introduction

Mr. Chairman, my name is Bert Murphy, and I am Chairman of the Board and Chief Executive Officer of Murphy Energy Corporation (founded in 1957), an independent oil and gas production and exploration company. My firm is headquartered in Roswell, New Mexico, and produces less than 1,000 Bbls/day of crude oil. We currently finance our daily operations with bank debt and private and public equity, as well as long-term notes.

As an alumnus (1950-B.S. in Petroleum Engineering) of Stanford University, I have retained a close interest in the affairs of my alma mater. Since September 1981, I have served as Chairman of the Petroleum Investment Committee, which manages $1.5 million in oil and gas assets for the Stanford School of Earth Sciences. The members of the Petroleum Investment Committee are petroleum engineers, geologists, and other experts in the field, and the Committee can call on the resources of other parts of the University for assistance, as necessary.

Summary

I strongly support S.1549 in both my roles as an independent oil man and as a fiduciary of a university endowment fund. However, the bulk of my comments will reflect my experience as an investment officer and manager of tax-exempt assets.

The Petroleum Investment Committee, School of Earth Sciences, Stanford University, is an experienced and prudent group of fiduciaries who are familiar with oil and gas investments of all kinds. The group which was authorized by the Board of Trustees in the 1950's, fully understands the market for oil and gas properties, and I know that they believe oil and gas working interests provide a prudent investment vehicle for endowment funds. As a member of an investment committee for an endowment fund, I perceive my role as one demanding careful screening and structuring of all petroleum investments for their ability to produce steady, current income while providing the potential for capital appreciation through price increase on the sale of oil and gas or through reserve additions. Royalties and production payments can provide the former, but not the latter. S.1549 would provide much needed investment flexibility to accept and keep gifts of limited partnership interests or to solicit such gifts of working interests.

The cost of private higher education has been rising steadily, while grants and other financial support programs have been reduced. Income from endowment funds increasingly must help to finance daily operations and fixed costs of universities. Maintaining the high educational standards of an institution like Stanford University requires additional resources, and the institution has set up investment committees, like the Petroleum Investment Committee to locate them. Successful alumni would like to see that quality maintained, and some are willing to support the institution with gifts of oil and gas working interests in producing properties. I believe that one of the charges of the Petroleum Investment Committee includes solicitation of large gifts and earning at least a 20% rate of return. This can only be accomplished if S.1549 is passed.

Finally, as an independent oil man, I believe that S.1549 would open up another, much-needed source of capital to the independent oil industry. Pension funds and universities could benefit by the positive investment characteristics of owning oil and gas working interests while independent oil firms could finance the development and maintenance of the U.S. hydrocarbon resource base.

Oil and Gas Working Interests are Prudent Investments

Currently, the income from various passive sources, as defined by Sec. 512 of the Tax Code, is exempt from tax. Common stocks, bonds, oil and gas royalties, and production payments are considered passive sources of income. A decade or so ago, endowments would buy or receive gifts of these income sources and hold them forever. For a ten-year period ended December 31, 1983, endowment funds experienced a median rate of return of 7.5%, which just matched the general rate of inflation in the economy. No real gains were made in the size of the endowment from investment activity, although colleges made real efforts to solicit capital contributions from alumni in order to achieve that capital appreciation. Real (1967 $) voluntary support amounted to $251/student at 827 colleges and universities in 1966, and accounted for 9.5% of expenditures. By 1982, real voluntary support per student was $140 and accounted for 6.4% of expenditures. In 1966, $1.4 billion was contributed, and in 1982, $4.9 billion was gifted to colleges and universities. However, expenditures were $15.2 billion in 1966 and $73.1 billion in 1982. Fundraisers and investment managers who assist colleges have to run hard just to try and stay in place.

Nowadays, most fiduciaries manage endowment funds more actively in an effort to achieve both income and capital appreciation, while taking only moderate levels of risk. Total returns (income plus appreciation) have improved as investment managers alter the portion of their portfolios devoted to corporate stocks and bonds over the course of the changing business cycle. Median returns often approach the S&P 500 index returns, but more is needed to help the educational institutions as other forms of federal and state financial assistance diminishes.

Nonetheless, diversification to reduce risk and steady cash flow remain prime investment goals for endowment funds. Common stock dividends can fluctuate with corporate profits, and many stocks offer income yields only in the 4-6% range, like the S&P 500 index. Stock price appreciation, however, can be significant but highly variable, so that total rate of return is also highly variable. Bonds offer steady cash flows and higher yields than stocks (about 12% for AAA bonds, now), but their prices are also variable with changes in U.S. interest rates. Thus, their returns are also highly variable. If the issuing entity's public credit rating changes, the investor can experience a permanent capital loss, as well. Holding a combination of stocks and bonds will provide reasonable income and reduce the risk inherent in each individual security. Royalties and production payments behave very similarly to bond interest income discussed above.

Diversification into real property like oil and gas working interests adds an important dimension to the standard investment portfolio in addition to its steady cash flow that's very competitive to bonds - the potential for capital appreciation, along with much lower rates of variability in both income and capital value. Capital values of oil and gas working interests are largely based on proved and potential reserves in the ground and the production history of the wells, both of which do not vary significantly.

Legally, a limited partner holding a working interest cannot impact the daily operations of the oil and gas property or the general partner. Therefore, the endowment funds would be a passive investor who desired the special characteristics of this investment vehicle - diversification that reduces variability in total portfolio returns, good income yields, and the potential for steady capital appreciation in the long run.

Currently, endowments must quickly liquidate gifts of oil and gas working interests, or place their income tax-exempt status at risk. Hurried sales of oil and gas working interests don't bring top dollar for the gifted assets. Yet as an investment officer, it is difficult for me to understand why ownership of a working interest like a limited partnership gives tax-exempt funds a competitive advantage over taxable entities, while a royalty interest or a production payment does not. Both investment vehicles bear the same degree of control over the asset or the general partner - none. Both investments have similar cash flow characteristics.

The last decade has seen the development of various kinds of public offerings of oil and gas working interests. At the same time, endowment fund fiduciaries have become more active asset managers. Financial innovation has been a hallmark of the U.S. capital markets, and the Tax Code should be updated to recognize those changes by passing S.1549.

Potential Source of New Capital for the Oil Industry

The independent oil industry, which does most of the exploration and development drilling in this country, could benefit from the chance to attract passive investors like pension funds, foundations, and endowment funds. These passive investors would probably allocate some small portion of their $700-800 billion in assets to oil and gas.

S.1549 prevents these potential passive investors from controlling the limited partnership and the general partner. Accumulation of tax-free funds in royalties and production payments is currently permitted, and this concept conforms to the true investment characteristics of a limited partnership working interest. Thus, the bill supports the spirit and intent of current tax laws by recognizing financial change and the development of passive limited partnership interests in oil and gas over the last 10-15 years.

Mr. **Moorhead**. I am vice chairman of the Petro-Lewis Corp. I think an adequate description of Petro-Lewis and its activities in oil and gas operations and investment management is pretty abundant in the prepared testimony. I am also the chairman of an ad hoc committee called The Investment Equity Committee, formed of people in the securities, pension fund management and advisory industries, to forward this legislation, believing it is in the public interest. I am also a governor of the Oil Investment Institute, a trade association which has endorsed this legislation in principle, and will meet next Tuesday to specifically consider, and I trust, endorse the specific legislation represented by S. 1549.

Rather than try to summarize the testimony in prepared form submitted previously, I would like to comment on a few highlight issues. The temptation has been from the opponents, including Treasury this morning, to compare this legislation to some ideal standard rather than to the practical circumstances that exist today. As a practical matter, there is no impediment now for tax exempts to invest free of the UBTI problem. There is simply an impediment to doing so in conventional formats, the conventional format being investing through limited partnerships which own working interests. That is the standard form of nonindustry participation in the oil industry, and it is denied to the tax exempt industry under present law because of the tax impediment. Further, the opponents choose to compare the abuse standard to some ideal. There is the full potential for abuse, and I think abuse is invited, under the situation that exists today with substantial amounts of money being channeled from tax-exempt institutions into oil and gas investments through tax avoidance structures rather than the straightforward conventional way the industry has developed over the decades. We would favor any improvements that can be offered. We would be prepared and are prepared to work with Treasury and other opponents to the bill as presently written to achieve the elimination of the abuse potential that has been alleged.

Finally, the bill does include—specifically addressing the Treasury's concerns—a provision that Treasury should promulgate regulations and rules that would tend to obviate some of the abuses that have been set up, perhaps as strawmen. The issue here I believe is one of competition. Petro-Lewis undertook this legislative initiative because we believed that there was no reasonable basis for anyone to oppose it. We find, to our dismay, that there are people who oppose it, as nearly as we can tell, because of a preference for keeping the situation as it is and avoiding further competition. We personally believe that competition and the access to the industry to new sources of capital is going to be very healthy for this country and for our industry in the long term. With that, sir, I invite your questions in the appropriate time.

Senator **Armstrong**. Thank you, Mr. Moorhead. Mr. Brumley?

STATEMENT OF I. JON BRUMLEY, PRESIDENT, SOUTHLAND ROYALTY CO., FORT WORTH, TEX.

Mr. **Brumley**. Thank you, Mr. Chairman. My name is Jon Brumley. I am president of Southland Royalty Company. I am here on behalf of Southland Royalty Company to testify against S. 1549, a bill to amend the Internal Revenue Code of 1954, to permit individual retirement accounts, qualified retirement trusts, and certain educational organizations to invest in working interests in oil and gas properties without incurring unrelated business taxable income. I would like a copy of my written statement included in the record.

Senator ARMSTRONG. We will be happy to have it.

[The prepared statement of I. Jon Brumley follows:]

STATEMENT OF I. JON BRUMLEY
SOUTHLAND ROYALTY COMPANY
ON
S. 1549

This written statement is submitted on behalf of Southland Royalty Company of Fort Worth, Texas in response to Senate Finance Subcommittee on Taxation and Debt Management Chairman Robert Packwood's announcement of hearings on five miscellaneous tax bills including S. 1549, the subject of this statement.

Southland Royalty Company - General Information

Southland Royalty Company was founded in 1924. Southland is the 15th largest independent domestic oil and gas producer and it has operations in almost all of the major oil and gas provinces in the United States including Alabama, Arkansas, California, Colorado, Illinois, Kansas, Louisiana, Mississippi, Montana, Nebraska, New Mexico, North Dakota, Ohio, Oklahoma, Texas, Utah and Wyoming. Southland Royalty is a member of the Domestic Petroleum Council ("DPC"). DPC is also opposed to this bill.

Southland's Position Regarding S. 1549

S. 1549 will amend the Internal Revenue Code of 1954 to provide that income from an investment in an oil and gas "working interest" by certain tax-exempt entities, such as qualified retirement trusts, individual retirement accounts and college endowments, is exempt from federal income tax. Southland is opposed to enactment of S. 1549 for the following reasons:

Competition with Taxpaying Entities

The taxation of unrelated business taxable income ("UBTI") which has been in the Internal Revenue Code since 1950, is based on the concept that tax-exempt entities are taxable at regular corporate rates on "active" business income which arises from activities which are unrelated to the entities' tax-exempt purposes. The tax on UBTI is imposed on nearly all exempt organizations as its coverage was extended by the Tax Reform Act of 1969.

The primary objective of UBTI is to eliminate unfair competition by placing the unrelated business activities of covered exempt organizations on the same tax basis as the nonexempt business entities with which they compete. The House Ways and Means Committee report on the Revenue Act of 1950 states:

> The problem at which the tax on unrelated business income is directed here is primarily that of unfair competition. The tax-free status of . . . organizations enables them to use their profits tax-free to expand operations, while their competitors can expand only with the profits remaining after taxes. Also, a number of examples have arisen where these organizations have, in effect, used their tax exemption to buy an ordinary business. That is, they have acquired the business with no investment on their own part and paid for it in installments out of subsequent earnings -- a procedure which usually could not be followed if the business were taxable.

The Senate Finance Committee commented that one major purpose of UBTI tax is to "make certain that an exempt organization does not commercially exploit its exempt status for the purpose of unfairly competing with taxpaying organizations." (See Rep. No. 94-938, 94th Cong., 2d Sess. (1976) at 601).

One of the specific problems and concerns Congress sought to address in the taxation of UBTI was the availability of pools or the accumulations of tax-exempt income which confer upon nontaxable entities an "unfair and harmful competitive advantage" over taxable entities. (S. Rep. No. 2375, 81st Cong., 2d Sess. (1950)).

In the case of an oil and gas drilling partnerships, pools of income created in the partnership, which would otherwise need to be withdrawn each year to pay tax on the partners' shares of partnership income, do not need to be distributed because tax-exempt entities have no income tax liability. The result of such a tax-free pooling of funds is that the tax-exempt partner in effect controls the underlying partnership business because it controls the capital in the business.

This bill will reverse a basic tax policy against unfair competition by tax-exempt entities which has been consistently applied for more than 30 years. This bill takes the position that investment in oil and gas working interests should be excluded from the UBTI tax because such investments are passive in nature and are not involved in the active conduct of a trade or business. As outlined above, the investments in oil and gas working interests are not passive because they would be directly in competition with taxable entities.

Southland, as well as other independents, depends on tax-exempt organizations to provide capital to fund operations but the capital is obtained through the traditionally allowed "passive" investments -- the purchase of common stocks and bonds. The proponents of this bill erred in comparing oil and gas investments in working interests specifically to stock and bond investments because comparing such investments is like comparing apples and oranges. Similarly, the tax law should recognize the difference between these types of investments and should encourage passive investments in stocks and bonds and discourage investments which compete with taxable entities.

Reallocation of Investment Funds

The legislation is intended to increase the availability of financing and the opportunity for oil and gas producers; however, it could decrease the opportunities to raise badly needed investment capital because it discourages investment by taxable entities because of the "uneven playing field" it creates. When taxable investors find that the tax-exempt investors have the advantage in raising capital in the oil and gas business, the taxable investor will seek other businesses to invest in where they are not always at a competitive disadvantage.

Additionally, by allowing tax-exempt organizations to invest in oil and gas working interests through limited partnerships, this bill would limit the traditional sources of capital from the industry, namely, the sale of stocks and bonds. This would occur because these funds would be siphoned off to working interests.

Tax-exempt entities achieve high rates of returns through the purchase of common stock investments in the independent oil and gas industry. Fortune magazine reported that the mining and crude oil producing industry provided a total return to common stock investors over the period of 1971 to 1981 of 15.4% for the Fortune 500 and 17.4% for the Fortune Second 500. Both rates of return over the 10-year period ranked the oil and gas industry second among all industries. The rate of return was practically double the median for all industries of 8.5% for the Fortune 500 which the proponents of the bill are apparently referencing. There is no evidence that the rates of return for direct investment in oil and gas working interests exceed the rates of return for common stock investments in the oil producing industry over any five or ten-year period of measurement.

Discrimination Against Other Tax-exempt Entities

This bill discriminates between types of tax-exempt entities. Only pension plans and college endowments can receive oil and gas production income tax free. All other tax-exempt entities are unfairly required to compete on the same uneven playing field with taxable entities in favor of pension plans and college endowments, despite the fact that both pension plans and college endowments already receive tax-deductible contributions. This bill provides a direct federal subsidy to these entities to the exclusion of other worthy non-taxable entities. There is no apparent justification for this distinction.

Risk Factors of Oil and Gas Working Interests

Assets which are owned by pension plans are used to provide pensions for the participants in the plan. The participants are staking their future well-being on the pension assets being there when the participant wants to retire. If the assets are not available to pay the pension, the participant must either rely on the public funds available or continue to work to provide support to live on. It is well known that direct investments in oil and gas working interests are generally highly speculative and risky. It is not sound tax policy that pension funds and college endowment funds should be invested in an oil and gas working interest where the entire amount of the investment can be lost if oil or gas is not found in quantities which can be produced in a economically feasible manner. Congress should encourage tax-exempt entities to invest in more conservative investments rather than risky and highly speculative investments, such as, direct investments in oil and gas.

The risks of the investment in oil and gas working interests are recognized in other parts of the tax code as there are special tax incentives for taxable investors. These incentives include the write off of intangible drilling costs, percentage depletion and the treatment of drilling funds as partnerships.

Related to the Exempt Purpose

The tax policy for allowing tax exemption is to encourage tax-exempt entities to concentrate on their purpose and not on business matters necessary to make a profit. For this reason, tax-exempt entities are prohibited from concentrating their efforts on business unrelated to their purpose for existence. The complexities of an investment in oil and gas working interest require that a tax-exempt entity become extensively involved in the oil and gas business just to make the decisions necessary to make prudent investments and to protect their capital. Tax-exempt entities should concentrate their efforts on their exempt purposes rather than the intricacies of the oil and gas business.

Acquisition Indebtedness

The bill's proposed acquisition indebtedness provisions, allowing borrowing to acquire oil and gas working interests, invites the precise abuses the various UBTI provisions have been enacted to deter.

Before the provision was enacted in 1969, tax-exempt entities used their tax status to acquire business through debt financing. The acquisition of an oil and gas working interests with debt allows exempt organizations to trade on their tax exemptions. This again results in an escalation in prices of acquiring oil and gas properties by taxable entities. If this provision is enacted, the price of acquiring oil and gas properties for taxable entities will be higher than tax-exempt entities. This higher price to taxable entities is the unfairness that the UBTI tax should be preserved to prevent.

Partnership Allocations

The bill contains provisions that purport to preclude tax sheltering abuses through special allocations. The bill still has the potential for creating generous tax shelter deductions for taxable limited and general partners through the use of special allocations, multiple entities and other techniques.

The bill does not prevent special allocations between general and limited partners or between the limited partnership and other partnerships, trusts or S corporations, which are in partnership with tax-exempt entities.

Also the rules do not prohibit changes in the sharing of profits ("flip flops") and the reallocation of income. The bill does not prevent the partnerships from staggering entry dates of various limited partners which will produce profit allocations through the use of distributions and contributions by the limited partners.

Combining a taxpaying entity with a non-taxpaying entity through a tax partnership creates a situation fertile for tax abuse. Such artificial shelters should be discouraged.

Investment Credit

Section 48(a)(4) of the Internal Revenue Code of 1954 and Section 1.48-1(j) of the Treasury Regulations excludes from the use of investment tax credit any property, which is used by a tax-exempt organization, unless the property is used in an unrelated trade or business and its income is subject to UBTI tax. It is unclear if property held by a partnership which has tax-exempt organizations as limited partners qualifies for the investment tax credit for all of the partners or none of the partners.

Permanent Deferrals

The funds invested by educational institutions and the income which is earned thereon does not constitute merely an income deferral with an eventual taxable payout to the beneficiaries but a permanent deferral of taxable income.

Money can be contributed (while receiving a tax deduction) to entities, which qualify for this exemption. The entities invest the money in oil and gas business and it will never be paid out to a taxable donor. Thus, this bill grants a complete exemption to the income even though the income is earned by operating a profitable business activity. This is poor tax policy because it reduces the charities responsiveness to the public because the charity is self-sufficient.

Limited Partner Status

The bill attempts to base its "passive" theory on the requirement in the bill that the tax-exempt entity must be a limited partner. The distinction between general and limited partners is irrelevant because the target of the UBTI is the "unfair competition" element of the business activity conducted by the partnership not the partner.

Conclusion

The exclusion of investments in oil and gas working interests from UBTI tax would be a reversal of a Congressional policy against unfair competition by tax-exempt entities which has been consistently applied for the last 30 years.

The enactment of this bill into law would siphon investment capital of tax-exempt entities away from traditional passive investments in stocks and bonds of domestic independent oil and gas companies and channel them to the investment in working oil and gas interests. Overall, this shifting of funds will be harmful to the oil and gas industry.

This bill also encourages pension funds and college endowment funds to be invested in inherently risky businesses where the entire investment can be lost if oil or gas is not produced in commercially economic quantities.

Additionally, the legislation is riddled with technical problems which encourage planning by taxable entities using tax planning techniques to take advantage of an entity's tax-exempt status. For these reasons, this legislation should not be adopted.

Mr. **Brumley.** Thank you, sir. The proposed legislation is not needed by the domestic oil and gas industry and will not provide incremental funds to the industry as proponents of the bill advocate. Rather, I believe, it would result in a reallocation of funds toward inappropriate, high risk investments. Southland Royalty Company, of which I am president, ranks fifteenth in size among U.S. independent producers. Southland, as well as other independents, depends on tax exempt organizations to provide capital through the traditionally allowed investments for tax exempt organizations: the purchase of common stocks and bonds. Allowing tax exempt organizations to invest in oil and gas working interests through limited partnerships would siphon off a portion of traditional sources of capital to the industry. When this legislation was introduced, it was justified by the proponents on the basis that the tax exempt institutions could avail themselves of greater rates of return through more direct investment, and that the traditionally permitted investments–stocks and bonds–have provided low rates of return. The proponents erred in comparing oil and gas investments specifically to stock and bond investments generally, an apples and oranges comparison. The comparison should have been oil and gas investments, specifically, to oil and gas, stock and bond investments, specifically, not to all stocks and bonds.

I am doubtful that tax exempt organizations can achieve better rates of return through direct investments as they could by providing equity in the form of common stock investments in the independent oil and gas industry.

Fortune magazine reported that the mining and crude oil producing industry provided a return to common stock investors over the period of 1971 to 1981 of 15.4 percent for the Fortune 500, and 17.4 percent for the Fortune second 500. Both rates of return over the 10-year period ranked our industry second among all industries. The rate of return was practically double the median for all industries of 8.5 percent for the Fortune 500 which the proponents of the bill are apparently referencing. I would challenge the proponents of this legislation to produce evidence that the rates of return for direct investment in oil and gas exceed these rates of return for common stock investments in the oil and gas producing industry over any 5 to 10-year period of measurement.

The original reason for the unrelated business taxable income provision was to prevent unfair competition by a tax exempt entity and an otherwise taxable business. The proposed change would allow competition in the direct investment of oil and gas properties by tax exempt institutions, whose after tax rates of return are considerably different than those required by tax paying businesses. Such a change would therefore overturn the tax policy which for the past 30 years has prevented a distortion of relative competitive positions in our industry.

Another reason I oppose this legislation is that direct investment in oil and gas properties is inherently risky. The nature of the risk of the business is recognized by our current tax laws which provide tax incentives for investment in oil and gas ventures. The concept of S. 1549 suggests that direct oil investments are not risky, and that special tax incentives for oil and gas investors are unnecessary. This is simply not the case. It is not appropriate nor should it be public policy to encourage tax exempt institutions to incur a high degree of risk and possible loss of money at the expense of their beneficiaries while trying to attain a rate of return which might not be higher than the returns available to traditionally allowed investments.

In summary, the basic tenets of this legislation are inherently unsound. I have highlighted a few arguments against this bill in my oral testimony and my written statement contains many more. The Treasury Department has also suggested several flaws in the legislation which makes this bill controversial. Pension plan managers have a fiduciary obligation to the working men and women of the United States. The actuarial assumptions used in estimating costs of pensions have historically been conservative. I believe that the investments made by those plans should match that conservatism. This legislation should not be adopted. I thank you, sir.

Senator ARMSTRONG. Thank you. Mr. Overgaard?

STATEMENT OF PAUL F. OVERGAARD, VICE PRESIDENT, INDEPENDENT SERVICE CO., INC., ALBERT LEA, MINN.

Mr. OVERGAARD. Mr. Chairman and members of the committee, I want to express my appreciation for this opportunity, the first opportunity I have had, to appear before a Senate committee. My name is Paul Overgaard. I am the vice president and coowner of Independent Service Co., Inc., a firm engaged in the design of pension and profit-sharing plans for small corporations. My firm also provides administrative assistance to small companies in the handling of their plans. Our salesmen are licensed as insurance representatives and as sales representatives for a broker/dealer offering mutual funds and limited partnerships.

Our pension clients fund their plans in a variety of ways. They use bank deposits, money market accounts, mutual funds, both equity and bond, life insurance contracts, guarantee investment contracts, and contracts for deed. A few are now investing in oil and gas income funds sponsored by the Damson Corp. In fact, it was Damson's reasonable and sound arguments for its product that was one of the principal reasons I became interested in oil and gas investments for qualified plans.

Mr. Chairman, I have a copy of a bulletin issued by Damson entitled "Why Damson Institutional Oil and Gas Income Funds?" which describes why oil and gas income funds constitute sound investments for pension funds, and I would like to submit that bulletin for inclusion in the record for your benefit.

Senator ARMSTRONG. We would welcome that.

[The prepared statement of Paul F. Overgaard and the bulletin follow:]

TESTIMONY OF PAUL OVERGAARD
VICE PRESIDENT AND CO-OWNER
INDEPENDENT SERVICE COMPANY
ON S. 1549
BEFORE THE SENATE FINANCE SUBCOMMITTEE
ON TAXATION AND DEBT MANAGEMENT

My name is Paul Overgaard. I am the Vice President and Co-Owner of Independent Service Company, Inc., a firm engaged in the design of pension and profit-sharing plans for small corporations. My firm also provides administrative assistance to small companies in the handling of their plans. Our salesmen are also licensed as insurance representatives and as sales representatives for a broker/dealer offering of mutual funds and limited partnerships.

Our pension clients fund their plans in a variety of ways: bank deposits, money market accounts, mutual funds (both equity and bond), life insurance contracts, guaranteed investment contracts, and contracts for deed. A few are now investing in oil and gas income funds sponsored by Damson Corporation. In fact, Damson's reasonable and sound arguments for its product were one of the principal reasons I became interested in oil and gas investments for qualified plans. Mr. Chairman, I have a copy of a bulletin issued by Damson entitled "Why Damson Institutional Oil and Gas Income Funds?" which describes why oil and gas income funds constitute sound investments for pension funds. I submit this bulletin for inclusion in the record of these hearings on S. 1549.

During the more than 20 years I have been serving the small investor and especially the small corporation retirement plan, I (and my clients) have learned many things. One is that there certainly is no single investment for all times. At one time most pension plans were funded with endowment insurance policies. Then, came the modernization through use of annuity contracts. Common stocks had their day in the sun in the mid to late 1960's, and I believe it was in 1968 that certain publications speculated as to the possibility that there might be a permanent shortage of common stocks because retirement plans would become such a huge market for them. This was followed in 1974-75 by equally ridiculous speculation that the equity markets were dead.

What the passage of time has really taught me is that diversification, expert selection and full-time supervision are the most important considerations in prudently managing assets. This is certainly true in accumulating assets for retirement.

Comingled accounts (mutual funds) have provided a way for these small plans to establish an equity position that meets the test of diversification, expert selection, and full-time supervision. Publicly offered limited partnerships investing in income producing oil and gas properties also offer a vehicle that will permit these small plans to diversify their investments even further.

One of the concerns I have in this business is the need to offer a broad range of prudent investments. A prudent investment is one that will meet the test of time and the test of quality and those characteristics cannot easily be defined. For instance, there are some mutual funds which do not meet these requirements in my opinion. There are many other investments which are not subject to the unrelated business income tax which in my opinion would not meet the fiduciary requirements under ERISA. On the other hand, investments in many oil and gas limited partnerships would constitute a prudent investment under ERISA.

This legislation will make prudent diversification possible and will be of particular interest to the kind of plan we serve. There are millions of small employers in this country, and a great many of them will welcome this change as an opportunity to diversify their plan investments and hopefully achieve a better rate of return, and thus, a better retirement for their employees.

This legislation will give opportunities for greater diversification and will allow those of us in the marketplace more sources of supply for this type of product.

WHY DAMSON INSTITUTIONAL OIL & GAS INCOME FUNDS?

The information in this bulletin is restricted to broker/dealer use only. It may not be reproduced in any form or manner and may not be shown to any prospective offeree. An offer may be made to a prospective investor only through a current prospectus and authorized sales literature. Each Damson oil and gas income partnership is a separate entity and there is no assurance that subsequent results will be the same.

All you need to sell Damson Institutional Oil & Gas Income Funds is an understanding of the oil and gas outlook and the investment potential within the institutional market. Answer these questions and you'll increase your sales: *WHY OIL AND GAS? WHY DAMSON OIL? WHY DAMSON INSTITUTIONAL OIL & GAS INCOME FUNDS?*

"Brokers...found out the buying public was interested in the cash yield promised by income funds. They haven't put down the phone since."

That was the conclusion of the *Oil And Gas Investor* in December, 1982. In fact, oil and gas income fund sales increased by over 30% last year and are projected to top $1.2 billion in 1983, a ten time increase over sales in 1980. As the March, 1983 *National Tax Shelter Digest* discovered, "among the major tax shelter investments, oil and gas income funds have grown at the most significant rate over the last three years."

WHY OIL & GAS?

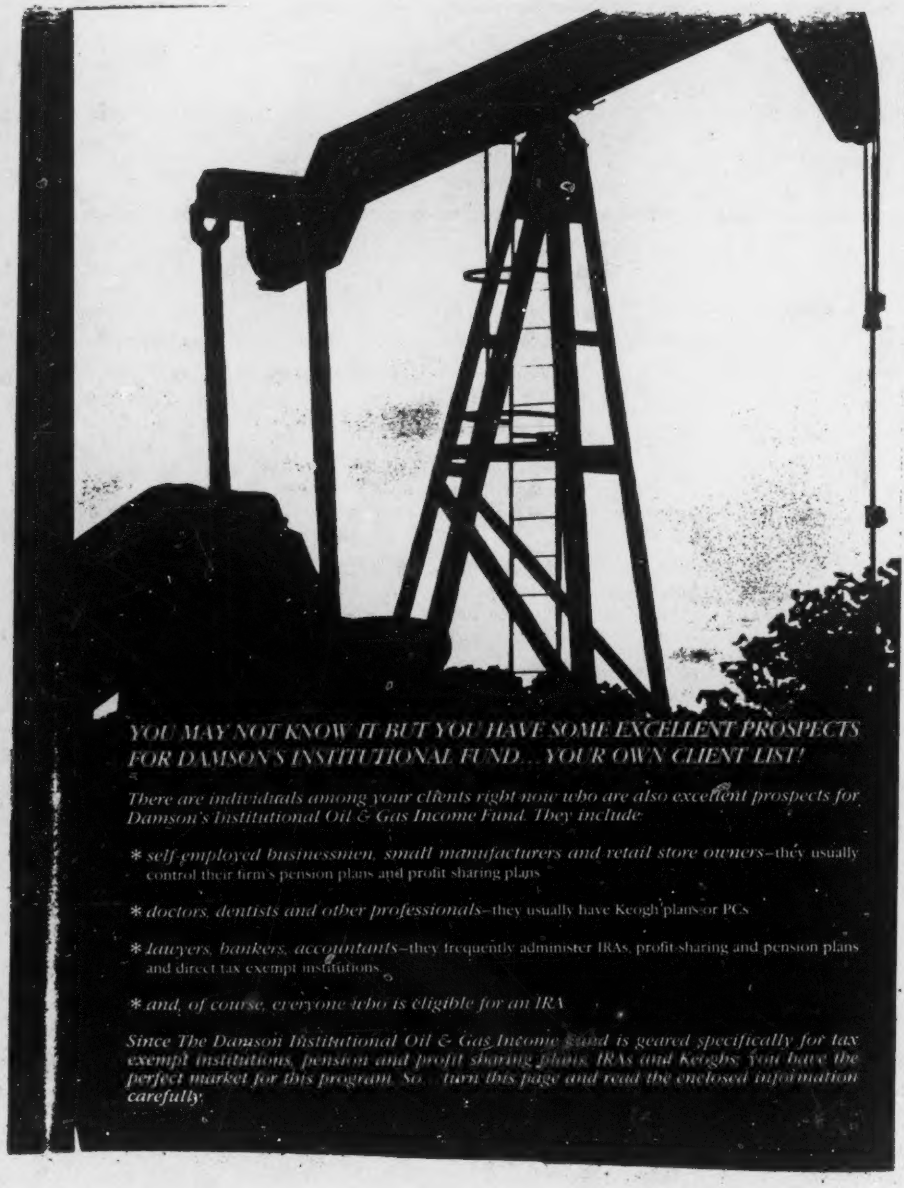
* *The U.S. is the largest consumer of oil and gas in the world*–approximately 14.7 million barrels a day by February, 1983–but the U.S. is currently producing only 10 million barrels a day, leaving a 4.7 million barrel a day shortfall.

* *Consider the contrast in domestic consumption vs. production between 1962 and 1983:*

	Consumption	Production	Shortfall
1962	10 million bbls.	8.5 million bbls.	1.5 million bbls.
1983	14.7 million bbls.	10 million bbls.	4.7 million bbls.

* *Many economists believe that the current price reductions in oil represent only a temporary condition, the result of a world wide recession accompanied by cutbacks in industrial production and an energy cost-conscious population*–this situation is expected to reverse itself by the mid to late 1980s–(According to the International Energy Agency), "an oil shortage is likely to develop after 1985 unless more is done to reduce dependence on imported oil." (*New York Times*, October 11, 1982)

* *In the meantime, many forecasters see the current situation as a scenario for increasing oil prices in the future*–"(Declining prices and oversupply) could do more damage to the already faltering efforts to develop alternative energy sources...conservation efforts might also be undermined. People would suddenly find it less expensive to drive big cars and more attractive to turn up their thermostats. Businesses would think twice about buying costly new energy-efficient equipment. Some economists fear that the industrial nations could once again become dangerously dependent on unstable and unreliable foreign oil supplies..." (*Time*, February 7, 1983)



YOU MAY NOT KNOW IT BUT YOU HAVE SOME EXCELLENT PROSPECTS FOR DAMSON'S INSTITUTIONAL FUND . . . YOUR OWN CLIENT LIST!

There are individuals among your clients right now who are also excellent prospects for Damson's Institutional Oil & Gas Income Fund. They include:

* *self-employed businessmen, small manufacturers and retail store owners*–they usually control their firm's pension plans and profit sharing plans
* *doctors, dentists and other professionals*–they usually have Keogh plans or PCs
* *lawyers, bankers, accountants*–they frequently administer IRAs, profit-sharing and pension plans and direct tax exempt institutions.
* *and, of course, everyone who is eligible for an IRA*

Since The Damson Institutional Oil & Gas Income Fund is geared specifically for tax exempt institutions, pension and profit sharing plans, IRAs and Keoghs; you have the perfect market for this program. So . . . turn this page and read the enclosed information carefully.

- *The increasing value of gas*–gas is now selling at an approximate average price of $2.00 per 1000 cubic feet while the BTU equivalency with the price of oil (at $30 a barrel) is $5 per cubic feet–gas prices are expected to rise toward this BTU equivalency as deregulation of gas occurs in 1985–in anticipation of deregulation, Damson has generally invested 70-80% of its funds in natural gas–"Natural gas is the single most important domestic source of energy in the United States" (Glenn C. Loury, Professor of Economics, University of Michigan concluded in a recent study)

WHY DAMSON OIL?

A major factor in U.S. oil and gas limited partnerships, Damson:

- *Has raised over $350 million in income fund subscriptions in the last year alone*
- *Manages over $1 billion in future net revenues for its own account and its fully vested limited partnerships*
- *As of February, 1983, Damson had purchased interests for its limited partners in over 4800 wells located in 612 fields in 23 states*
- *Is more than just a fund management company*–Damson is also an independent oil and gas exploration and production company with headquarters in Houston and regional offices throughout the oil and gas producing states
- *Damson is offered many of the major producing properties on the market and applies exacting standards to its acquisition review*–from September, 1977 through January, 1983, out of a total of 3300 properties initially reviewed, only 396 merited further consideration–the result was 66 successful purchases
- *Because of our continued success in income fund sales, Damson is in a strong position to take advantage of the current availability of excellent high yielding properties*–According to President Barrie M. Damson, "We intend to take advantage of opportunities in what we believe to be an excellent buyer's market"
- *An example is Damson's acquisition from Petroleum Corporation of Texas ("Petco") in February, 1983*–for approximately $160 million, Damson purchased for itself and its limited partners interests in over 2100 producing oil and gas wells located on approximately 425 properties in 11 states with future net revenues of approximately $544 million (escalated) and $312 million (unescalated)
- *Robert Stanger of the* Stanger Report *is one of the many economic forecasters who shares Damson's view of the current market:* "The price of purchasing existing reserves is extraordinarily attractive, probably 40% less than the price a year ago" (*Oil and Gas Investor*, December, 1982)

WHY DAMSON INSTITUTIONAL OIL & GAS INCOME FUNDS?

- *Damson has the* only *oil and gas income fund on the market which is geared specifically for institutional investors*–"Damson Oil Corporation has introduced a unique program structured to accommodate both taxable and nontaxable institutions." (*Institutional Investor*, July, 1982)

✱ ***What makes Damson's Institutional Oil & Gas Income Fund "unique" is its two-tier structure***–operated to enable tax-exempt investors to avoid the Unrelated Business Taxable Income ("UBTI") that may result when a tax-exempt institution participates directly in a business other than that for which the exemption was issued

✱ ***Since passive income, such as royalties, dividends and interests remain untaxed, subscribers purchase interests in a Limited Partnership which acquires an Operating Affiliate which actually purchases the oil and gas properties***–Since the Partnerships hold only indirect interest in the properties, all income they receive is passive and, therefore, exempt from "UBTI"

Damson Institutional Oil & Gas Income Fund offers many of the same features as the Damson Oil And Gas Income Fund including:

✱ ***Direct participation (through the Operating Affiliate) in the ownership of oil and gas***–an increase in oil and gas prices, therefore, flows through to the limited partners (in a 90%-10% split with the General Partner before payout, 85%-15% thereafter) where, for example, the value of oil company stock would be influenced by factors other than price increases (refining, transportation costs, retailing, foreign politics)–to illustrate this, from October, 1971 to December, 1982, the price of crude oil rose by 777% and the price of natural gas by 1160% but Exxon's stock during the same period declined by 16%

✱ ***A relatively safe, predictable and regular source of income***–with quarterly distributions

✱ ***A possible hedge against inflation***–"oil and gas are finite commodities and, in the long term, the prices will be significantly higher" (*National Tax Shelter Digest*, March, 1983)

✱ ***There is no cost or risk of development drilling***–however, Damson's limited partners (through the Operating Affiliate) receive a back-in from any development drilling that is farmed out

✱ ***Liquidity in the form of annual buyout offers (commencing 1 year after formation)***–pension or profit sharing plans, IRAs or Keoghs which are Limited Partners may request partial buyouts ($1000 minimum) so that their plans will have sufficient liquidity to meet the investors' actuarial distribution requirements

There is a vast institutional market which is looking to diversify out of traditional stock and bond investments into more tangible assets like oil and gas. "Pension fund assets alone stand at $750 billion and could well hit the $3 trillion mark by 1995," according to *Financial World*, June, 1982.

In the last two years, institutions have put more than $2 billion into oil and gas investments. In only nine months, Damson's first two Institutional Oil & Gas Income Fund partnerships generated close to $30 million in subscriptions. And we, along with other economic forecasters, believe that 1983 will be the best year ever for oil and gas income funds.

Mr. **Overgaard**. During the more than 20 years I have been serving the small investor and especially the small corporation retirement plan, I and my clients have learned many things. One is that there certainly is no single investment for all times. At one time most pension plans were funded with endowment insurance policies. Then came the modernization through the use of annuity contracts. Common stocks had their day in the sun in the mid to late 1960s, and I believe it was in 1968 that certain publications speculated as to the possibility that there might even be a permanent shortage of common stock because retirement plans were becoming such a huge market for them. That was followed in 1974 and 1975 by the equally ridiculous speculation that the equity market was dead. What the passage of time has really taught me is that diversification, expert selection and full-time supervision are the most important considerations in prudently managing assets. This is certainly true in accumulating assets for retirement.

Commingled accounts—mutual funds—have provided a way for small plans to establish an equity position that meets the test of diversification, expert selection and full-time supervision. Publicly offered limited partnerships investing in income producing oil and gas properties also offer a vehicle that will permit small plans to diversify those investments even further.

One of the concerns I have in the pension business is the need to offer a broad range of prudent investments. A prudent investment is one that will meet the test of time, and the test of quality, and those characteristics cannot easily be defined. For instance, there are some mutual funds which do not meet these requirements in my opinion. There are many other investments which are not subject to the unrelated business income tax which, in my opinion, would not meet the fiduciary requirements under ERISA. On the other hand, investments in many oil and gas limited partnerships would constitute a prudent investment under ERISA.

This legislation will make prudent diversification possible and will be of particular interest to the kind of plan that I serve. There are millions of small employers in this country, and a great many of them will welcome this change as an opportunity to diversify their plan investments and hopefully achieve a better rate of return and thus, a better retirement for their employees. I think this legislation gives opportunities for greater diversification and, importantly, it allows us in the marketplace more sources of supply for this type of product. Thank you, Mr. Chairman.

Senator **Armstrong**. Thank you very much.

Mr. Cain?

STATEMENT OF EDWIN E. CAIN, VICE PRESIDENT, GOVERNMENT RELATIONS, APACHE CORP., MINNEAPOLIS, MINN.

Mr. **Cain**. Thank you, Mr. Chairman, Senator Long, and Senator Matsunaga. I am also entering written testimony which I would appreciate being placed into the record.

Senator **Armstrong**. It will be placed in the record in its entirety.

[The prepared written statement of Edwin E. Cain follows:]

TESTIMONY OF EDWIN E. CAIN
VICE PRESIDENT GOVERNMENT RELATIONS
APACHE CORPORATION
ON S. 1549
BEFORE THE SENATE FINANCE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

Mr. Chairman, I am representing Apache Corporation as Vice President for Government Relations. Apache Corporation, an oil and gas exploration, development and production company with both industrial and agricultural operations, has offered registered drilling limited partnerships to the investing public since 1956. Apache's corporate headquarters are located in Minneapolis, Minnesota, and it has operations in more than 30 states.

Apache's twenty-six year history in oil and gas investments and the company's experience in working with tens of thousands of investors, has developed for the corporation a reputation for sound, careful management. Based on our experience and our knowledge of the industry, Apache fully supports S. 1549, introduced by Senator Armstrong and co-sponsored by nine of his colleagues on the Senate Finance Committee.

This bill permits qualified trusts and certain educational organizations to receive income from limited partnerships that own working interests in domestic oil and gas properties without being subject to a tax penalty under the unrelated business taxable income provisions of the Internal Revenue Code.

At the present time, both pension trusts and college endowments make passive investments in stocks, bonds, gas and oil royalties, and other options without being subject to the tax penalty. Pension funds can now invest in real estate limited partnerships, but not in mainstream oil and gas limited partnerships. A purpose of the tax on unrelated business income was to prevent unfair competition between tax exempt and taxable entities. It was not the purpose of the tax to penalize specific types of passive investments or to differentiate between specific investments in a particular industry. Yet this situation exists today.

It is illogical to distinguish between investments in oil and gas royalty and net profits interests and investments in oil and gas working interests when the latter are held in passive form. S. 1549 insures that qualified oil and gas investments are truly passive by requiring that they be held in limited partnership form. For this reason, S. 1549 is consistent with current tax policy and maintains and strengthens that policy.

Furthermore, S. 1549 should result in no loss of income to the federal government. It is likely that the increased investment in oil and gas working interests by pensions and universities will result in additional investments by other taxpaying limited partners and the taxable general partner. Other passive investments currently exempted from tax require no similar investment by taxpaying entities.

S. 1549 permits pension trusts to diversify their portfolios to include working interests in oil and gas operations. This diversification should result in greater returns on their investment dollar, which in turn will provide a stronger retirement program for the participants in the pension program.

A major concern of Apache is the inability of investors to contribute oil and gas properties to college and university endowments. A recent experience by an Apache corporate officer resulted in a significant donation to a major university being rejected on the basis that it would produce unrelated business income tax. This is neither a unique nor an unusual situation. Currently, when a tax-exempt organization accepts gifts of oil and gas properties owned in limited partnership form, they must be sold at a considerable loss in order for the organization to avoid being subject to the unrelated business income tax.

Higher education has been confronted with severe economic problems during the past few years. Traditional sources of revenue have been greatly reduced at the very time that greater demands are being made on these institutions. S. 1549 permits college and university endowments to receive gifts of oil and gas limited partnership interests, thus providing a much needed, new source of revenue.

The petroleum exploration and production industry is capital intensive, and requires continuous infusions of new capital. Pension funds hold a growing proportion of investment capital; in fact pension and thrift plan assets have been estimated at $940 billion in 1982. The oil and gas industry is at a considerable disadvantage in attracting capital because pension funds are not available to them. The lack of capital in the oil and gas industry has contributed to a depression in drilling activities among the 10,000 independent producers who are responsible for nearly 90% of our country's gas and oil exploration and development. Drilling activity dropped 40% in 1982, and investments in drilling in 1983 are a fraction of past years. Apache in particular has reduced drilling expenditures from over $70 million in 1981, to $37 million in 1982, to less than $25 million planned for 1983, and we are one of the more aggressive independent producers. It is imperative that new sources of capital be made available and pension funds are clearly major potential investors.

This proposed legislation offers beneficial results to colleges and universities, pension funds, and the oil and gas industry. It is therefore difficult to find a valid basis for objection, since the vast majority of independent gas and oil producers support S. 1549. The Oil Investment Institute voted unanimously in 1982 to support the changes now articulated in S. 1549. Objection appears to have developed only in the case of those companies who perceive that their existing investment offerings to exempt organizations would be threatened by S. 1549, which widens those opportunities. For example, opposition now seems to come from some companies that have established royalty trusts.

Royalty trusts work in the following manner. They either purchase or acquire by way of distribution from oil and gas operators royalty interests in both producing and non-producing oil and gas properties. Typically, the trustee receives royalty income and distributes it to the holder of the trust unit, who reports the income as royalty income. Thus, if the unit is held by an exempt organization, this income is not treated as unrelated business taxable income. Nevertheless, the income is entirely dependent on the extent to which oil and gas is produced from the underlying properties, and in the case of non-producing properties, this return is dependent upon oil and gas yet to be produced.

If the underlying properties are held by a limited partnership instead of a royalty trust, the income allocated to an exempt investor who is a limited partner constitutes unrelated business taxable income. This is because the partnership's income is income from a working interest rather than from a royalty. In both cases, the role of the investor is entirely passive and the rate of return is dependent on whether or not oil and gas is or will be produced by the operator from the underlying properties. There should be no arbitrary tax distinctions drawn between these essentially similar types of investments.

It has also been stated that S. 1549 will permit exempt organizations to obtain an "unfair advantage" over taxpaying entities in the acquisition both of producing and non-producing oil and gas properties. However, this bill in no way affects the direct acquisition of oil and gas properties by an exempt organization. It simply enlarges the opportunities for exempt organizations to invest passively in oil and gas properties by permitting them to invest as limited partners in partnerships that have a taxable general partner. Under the bill, the general partner must be unrelated to and not controlled by any exempt limited partner. All oil and gas operators will now have equal access to a new source of capital. Accordingly, S. 1549 will not only eliminate the unfair discrimination that today exists between passive investments in oil and gas but will do so in a way that will stimulate, not restrict, competition in the oil and gas industry.

Mr. Chairman, it is my hope that your Committee will soon act favorably in reporting this most desirable legislation.

CORPORATE HEADQUARTERS / FOSHAY TOWER / MINNEAPOLIS, MINNESOTA 55402

Apache
CORPORATION

EDWIN E. CAIN, Vice President-Government Relations

612/332-7222

September 15, 1983

BY HAND

The Honorable Bob Packwood
Chairman
Senate Finance Subcommittee on
Taxation and Debt Management
SD 219 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator Packwood:

On behalf of Apache Corporation, I had the privilege of appearing as one of several panelists before the Subcommittee on Taxation and Debt Management on August 1, 1983, to testify in favor of S. 1549. As you know, this bill would exempt from unrelated business income tax the income from investments by universities and pension trusts in working interests in oil and gas wells, if such interests are held in limited partnership form. Mr. Ronald A. Pearlman, Deputy Assistant Secretary (Tax Policy) of the Department of the Treasury, appeared in opposition to S. 1549. He stated that the Treasury Department opposed S. 1549 and, in his discussion, advanced a number of reasons why it did so. I believe that Mr. Pearlman's testimony was in large part overly simplistic and failed to deal adequately with the desirable policy goals of the legislation.

In addition, Mr. Pearlman raised the spectre of potential abuse involving the transfer of tax benefits from tax exempt partners to taxable partners, without paying much regard to the fact that the bill contains carefully drafted provisions specifically designed to prevent such abuses. Accordingly, I attach certain additional comments relating to Mr. Pearlman's testimony. I respectfully request that these comments be made a part of the permanent record of the hearings on S. 1549.

Sincerely yours,

(s) Edwin E. Cain

Edwin E. Cain

cc (with encl):

The Honorable Robert J. Dole
Chairman
Senate Committee on Finance
SD 207 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable William L. Armstrong
Senate Finance Subcommittee on
Taxation and Debt Management
SD 219 Dirksen Senate Office Building
Washington, D.C. 20510

ADDITIONAL COMMENTS
OF
EDWIN E. CAIN
VICE PRESIDENT GOVERNMENT RELATIONS
APACHE CORPORATION
ON S. 1549
IN RESPONSE TO STATEMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
OF THE
SENATE COMMITTEE ON FINANCE

At the hearing held before the Subcommittee on Taxation and Debt Management of the Senate Committee on Finance on S. 1549 on August 1, 1983, Mr. Ronald A. Pearlman, Deputy Assistant Secretary (Tax Policy) of the Department of the Treasury, appeared in opposition to S. 1549. He stated that the Treasury Department opposed S. 1549 and, in his discussion, advanced a number of reasons why it did so. These comments are submitted in response to Mr. Pearlman's testimony.

S. 1549 Will Not Lead to Repeal of the Unrelated Business Income Tax

Mr. Pearlman's first objection is that enactment of this legislation can be expected to lead to repeal of the unrelated business income tax wherever exempt organizations invest through limited partnerships. This conclusion is a complete over-dramatization of the potential effects of the bill. It is occasioned, I suggest, by a misunderstanding of the way in which oil and gas investments are made and of the competitive effects of the bill, coupled with an overly restrictive interpretation of the intent of Congress in enacting Section 512 of the Internal Revenue Code in 1950 (which excluded, among other items, royalties and net profits interests from unrelated taxable business income). Treasury appears to fear that S. 1549 will constitute precedent that would erode the long-standing rule that an exempt limited partner (or any exempt partner) receives unrelated business taxable income equal to its share of income from an unrelated business activity conducted by the partnership. In permitting certain exempt investors to hold oil and gas working interests as limited partners without incurring unrelated business income tax, S. 1549 is effectuating a limited legislative change that would do no more than equate one type of passive investment in oil and gas properties (i.e., investments as limited partners in working interests) with a type of passive investment in oil and gas interests that has long been exempt under IRC § 512 (i.e., investments in royalties, net profits interests and production payments). The limited partnership format is used as a ready administrative device to assure that the owner of the working interest holds the investment passively, thereby equating it in all respects to a royalty. There is no policy or other reason to apply the principle of S. 1549 to free exempt limited partners from tax on all partnership business income, whether it be from automobile manufacturing or the spaghetti or any other business.

As was pointed out by the Independent Petroleum Association of America ("IPAA") in its excellent statement submitted to this Subcommittee, interest in oil and gas properties are generally held in two forms: one form consists of "nonoperating" interests, that is, royalties (whether carved out or overriding), net profits interests or production payments. These interests constitute rights to reserves in place which, it is commonly stated, are not required to bear a proportionate share of the costs of exploration, development or production (this statement is, of course, not strictly true in all instances: the owner of a net profits interest does indirectly bear such costs, since his share is paid out of his share of revenues). Income from these types of interest has been deemed since 1950, under IRC § 512, not to be subject to unrelated business income tax, even where such interests are directly held by the exempt organization.

On the other hand, oil and gas interests may also be held in the form of "operating interests" or "working interests" i.e., interests which bear a portion of the costs of exploration, development and production. A "working interest" may not in fact represent a riskier investment than a royalty or net profits interest, since in all instances the economic return is derived from whether or not, and to what extent, oil and gas is in fact produced. But the return is commonly greater because the obligation to bear a larger share of the costs is higher. Since 1950, income from "working interests" has been held to constitute income from a trade or business and, hence, to be unrelated business income.

But this tax categorization is too broad. The owner of a working interest may or may not be actually engaged in business. Typically, working interests are acquired not only by oil and gas drillers and developers, who obviously are engaged in business, but also as pure investment property by passive investors who hold the same quantum of interest as a driller or other operator, but whose property is managed for them by third parties through what is commonly called an "operating agreement." These two types of investment obviously differ -- but no distinction is made for tax purposes: the working interest owner is considered, merely by virtue of his ownership, to be engaged in a "trade or business" even if the management of the property is entirely delegated to a third party operator. As the IPAA pointed out, in the case of oil and gas properties, it is the nature of the interest in the properties and not the activities with respect to them which now determines the existence of a "trade or business." This lack of differentiation for tax purposes is not a rational one and no policy consideration requires that it be maintained.

For a number of reasons already submitted to your Subcommittee by representatives of oil and gas companies, colleges and universities and pension funds, it is desirable to allow certain exempt organizations to invest passively in oil and gas working interests. S. 1549 permits this, doing so by using the limited partnership (which is a traditional vehicle for investment in the oil and gas industry) to assure that such investment will in fact be "passive" in nature and will not be utilized by active operators. This is all that the bill does; it in no way suggests that other trades or businesses engaged in by partnerships should somehow be considered to give rise to passive income in the hands of partners. Mr. Pearlman's fears are completely unjustified.

The legislative history of the Revenue Act of 1950 discloses no policy reason why income from working interests, if held passively, should be treated differently from income from rents, royalties, dividends and interest, which, as Mr. Pearlman observed, are the traditional types of income long recognized as proper for educational and charitable organizations. In the case of royalties, the legislative history makes it clear that Congress intended to include "overriding" royalties, thereby benefitting the landowner. H. Rep. No. 2319, 81st Cong., 2nd Sess. 38 (1950). The regulations further included a net profits interests and certain production payments in the category of a of royalty. Regs. § 1.512-1(b) Excluding such income from unrelated income has obviously not resulted in serious competition for taxable businesses having similar income. However, Mr. Pearlman implies that extending the definition of royalties to include passively-held working interests would be likely to result in serious new competition for taxable businesses having similar income. The contrary is, in fact, the case: this action will stimulate competition in the oil and gas industry.

S. 1549 Will Stimulate Competition in the Oil and Gas Industry

A fair reading of the bill discloses that it is neither intended to, nor will its consequences be, to provide exempt organizations with an anti-competitive advantage over taxable oil and gas businesses. Rather, the purpose of the legislation is to facilitate -- without any material loss of revenue -- increased portfolio investment by exempt organizations in the oil and gas industry through established investment channels, thereby benefitting the entire industry. This is done by requiring such investment to be made through programs managed and operated by taxable, non-controlled general partners. In this way, all taxable oil and gas operators will have access on equal terms to a new source of capital. At present, such investment by exempt organizations can be made only in limited ways (e.g., royalty trusts) or in certain highly sophisticated institutional programs especially designed for major exempt funds (e.g., Damson Institutional Fund). Further, the proposed legislation is no more anti-competitive than existing law as it applies to oil and gas investment. Under present law, tax-exempt investors can pool tax-exempt income by investing in royalty interests or net profits interests. As I have noted above, income from these types of investments is excluded from unrelated business income tax. Such income can therefore be accumulated without tax by the exempt organization to acquire further investments.

Limited Partners Are Passive Investors

Mr. Pearlman argues that limited partners are not "necessarily" passive investors and that they enjoy opportunities for "substantial active involvement" in the business of the venture. This appears to be a clear misreading by him of the law of limited partnerships. The rights granted to limited partners under the 1976 Revised Uniform Limited Partnership Act (RULPA), as under its predecessor (ULPA), are in fact extremely restricted.

Basically, these rights are to inspect and copy certain of the partnership records (§ 305(1); to obtain from the general partner information about the state of the business and financial condition of the partnership (§ 305(2)(i)), copies of the partnership's tax returns

(§ 305(2)(ii)), and other information regarding the partnership's affairs as is just and reasonable; and to apply for judicial dissolution and winding up of the partnership (§§ 802, 803). In addition, but only to the extent that the partnership agreement does not have specific governing provisions, a limited partner is entitled to allocations of profits and losses (§ 503) and distributions (§ 504) on the basis of his relative contribution; to withdraw upon six months' notice (§ 603); upon withdrawal to receive the fair value of his interest (§ 604); to assign his interest (§ 702); to wind up the partnership (§ 803); and to receive distributions upon winding up of the partnership (§ 804). Whether rights in the foregoing respects are granted in the partnership agreement or, because the agreement is silent, by the RULPA, they cannot be said to cause the limited partner or his relation to the partnership's investments or the partnership's investments themselves to be active rather than "passive."

Contrary to the suggestion in the Treasury Statement, the RULPA does not give a limited partner the right to consult with and advise a general partner or to vote on removal of a general partner. Those are simply some of the activities that a limited partner may engage in without being considered to have participated in control of the business of the partnership so as to endanger his limited liability (§ 303). For a limited partner to have rights in those respects, they must be granted in the partnership agreement. Even where rights in those respects are granted in the partnership agreement -- for instance, the right of limited partners having a specified minimum percentage of the total partnership interest to vote to remove a general partner or to dissolve the partnership -- they do not cause the limited partners to be other than "passive" investors in the partnership and, through it, in the partnership's investments or cause the partnership's investments to be other than "passive." What is important to note -- and what Mr. Pearlman ignores -- is that both the investing limited partner (and the investment that results in distribution to him of a share of partnership income) are no less "passive" than the nonmanager stockholder of a corporation (and the investment that results in dividends to him out of corporate income).

The Question of Special Allocations

Mr. Pearlman further indicates concern that the partnership allocations may be used to transfer tax benefits from tax-exempt partners to taxable partners. However, the bill contains a number of provisions carefully designed to deal with this problem. In light of them, Mr. Pearlman's points are not persuasive.

Mr. Pearlman refers to certain "technical difficulties" with the bill. For example, the bill does not require that the allocation of basis be consistent with the allocation of income or gain. It also does not specifically deal with the allocation of capital gain as distinct from ordinary income or with the distribution of appreciated property. In fact, S. 1549 directly addresses these issues in Section 16B, which provides that the Secretary has the authority to prescribe regulations to deal with "arrangements" that might be utilized for the principal purpose of avoiding the bill's prohibitions on misallocating deductions, credits and similar items as between taxable and tax-exempt partners to take advantage of tax status. If Mr. Pearlman prefers to load the statute with these rules, rather than to handle them more flexibly in the regulations as the bill proposes, I am sure the sponsors of the legislation would have no objection to including appropriate further amendments in the legislation.

For the same reason, Mr. Pearlman's expressed fears concerning the potential abuse to be found in the area of partnership "flip flops" are equally groundless. The typical "flip flop" in the oil and gas industry would not be attractive either to taxable or tax-exempt partners: it is one in which the limited partners are allocated a larger share of income deductions and credits until their investment is recovered (and, incidentally, the front end costs are largely written off), at which point a larger share of the income is allocated to the general partner. Mr. Pearlman is probably concerned with a "reverse flip flop." In my judgment, any such provision would equally be likely to run afoul of the delegation of authority given to the Treasury to deal in the regulations with tax motivated "arrangements," but here again I am sure the sponsors would have no objection to clarifying amendments if that is thought necessary.

Other Concerns

Mr. Pearlman also expressed concern that investments by exempt entities in limited partnerships might be used to benefit taxable partners in ways other than by the transfer of tax benefits. For example, a limited partnership with exempt partners might conduct exploratory drilling on a tract of land that can benefit the owners of adjacent land. This is a problem that exists today and is dealt with by the imposition under state laws of fiduciary obligations on general partners that run to limited partners, taxable and exempt alike, and by the guidelines of the North American Securities Administrators Association Inc. ("NASAA Guidelines"). This is a non-tax matter of disclosure and fair dealing that is essentially unaffected by whether or not the investors in oil and gas programs are exempt organizations.

Mr. Pearlman's final point is that allowing the use of debt financing contained in S. 1549 would lead to the abusive use of exemptions, objecting in particular to the fact that restrictions on sale-leasebacks in the bill do not apply to sale-leasebacks between the limited partnership and a person related to the general partner. The answer to this concern is that it is frequently necessary in the oil and gas industry to permit financing arrangements or property transfers between affiliated entities and the bill not only contains the same anti-abuse provisions included by Congress in IRC § 514(c)(9) (relating to real estate debt financing by pension funds) but also a further safeguard against sale-leaseback abuses, namely, that the terms of any sale or lease must be consistent with the terms of similar transfers in the geographic area. Since such similar transfers would involve taxable persons on both sides of the transaction, it is just not likely, as an economic matter, that oil and gas programs operated by taxable general partners but having exempt limited partners would be able in any fashion to trade on the exempt status of the latter. If so, the Treasury is provided with adequate tools in its arsenal to attack the transaction.

Mr. CAIN. I am representing Apache Corp. as vice president of Government Relations. Apache Corp. is a gas and oil exploration, development and production company with both industrial and agricultural operations, and we have offered registered drilling partnerships to the investing public since 1956. It is somewhat unique that Apache is located in Minneapolis, Minn., which is a nonoil and gas producing State. It seems that our greatest natural resources over the past years have been our presidential candidates rather than our gas and oil. However, our 26-year history in gas and oil investment, and the company's experience in working with tens of thousands of investors, has developed for the corporation a reputation for sound and careful management. And based on our experience and our knowledge of the industry, Apache fully supports S. 1549.

At the present time, both pension trusts and college endowments make passive investments in stocks, bonds, gas, and oil royalties, and other options without being subject to the unrelated business income tax penalty. Pension funds can now invest in real estate limited partnerships, but not in mainstream oil and gas limited partnerships. A purpose of the tax on unrelated business income was to prevent unfair competition between tax exempt and taxable entities. It was not the purpose of the tax to penalize specific types of passive investments or to differentiate between specific investments in a particular industry. Yet this is precisely the situation that exists today.

It is illogical to distinguish between investments in oil and gas royalty and net profits interests and investments in oil and gas working interests when the latter are held in passive form. S. 1549 insures that qualified oil and gas investments are truly passive by requiring that they be held in limited partnership form. For this reason, S. 1549 is consistent with current tax policy and, in fact, maintains and strengthens that very policy. Further, S. 1549 should result in no loss of income to the Federal Government. It is likely that the increased investment in oil and gas working interests by pensions and universities will result in additional investments by other taxpaying limited partners and the taxable general partner. Other passive investments currently exempted from tax require no similar investment by taxpaying entities.

A major concern of Apache is the inability of investors to contribute oil and gas properties to college and university endowments. A recent experience by an Apache corporate officer resulted in a significant donation to a major university being rejected on the basis that it would produce unrelated business income tax. At the present time it is difficult. The proposed legislation does offer beneficial results to colleges and universities, pension funds, and the oil and gas industry. It is therefore difficult to find a valid basis for objection, since the vast majority of independent oil and gas producers support S. 1549.

As mentioned, the Oil and Gas Investment Institute voted unanimously in 1982 to support the changes now articulated in S. 1549. Objection appears to have developed only in the case of those companies who perceive that their existing investment offerings to exempt organizations would be threatened by S. 1549, which broadens the investment opportunities for qualified trusts. For example, opposition now seems to come from some companies that have established royal trusts. Royalty trusts work in the following manner. They either purchase or acquire by way of distribution from oil and gas operators royalty interests in both producing and nonproducing oil and gas properties. Typically, the trustee receives royalty income and distributes it to the holder of the trust unit, who reports the income as royalty income. Thus, if the unit is held by an exempt organization, this income is not treated as unrelated business taxable income. Nevertheless, the income is entirely dependent on the extent to which oil and gas is produced from the underlying properties, and in the case of nonproducing properties, this return is dependent upon oil and gas yet to be produced.

If the underlying properties are held by a limited partnership instead of a royalty trust, the income allocated to an exempt investor who is a limited partner constitutes unrelated business taxable income. This is only because the partnership's income is income from a working interest rather than from a royalty. In both cases, the role of the investor is entirely passive; the rate of return is dependent on whether or not oil and gas is or will be produced by the operator from the underlying properties. There should be no arbitrary tax distinctions drawn between these essentially similar types of investments.

It has also been stated that S. 1549 will permit exempt organizations to obtain an unfair advantage over taxpaying entities in the acquisition of both producing and nonproducing oil and gas properties. However, this bill in no way affects the direct acquisition of oil and gas properties by an exempt organization. It simply enlarges the opportunity for exempt organizations to invest passively in oil and gas properties.

Mr. Chairman, it is my hope that your committee will soon act favorably on this legislation. And I would like to request that the record be kept open until September 15 for additional testimony.

Senator ARMSTRONG. Thank you very much. We appreciate your statement. Senator Long?

Senator LONG. Well I just wanted to ask one of the witnesses, is it not true that we have had anywhere from 50 to 60 percent of our drilling rigs shut down?

Mr. MOORHEAD. Yes, sir. In the last 18 months the drilling rig count has dropped from approximately 4500 to about 1800. It now is showing a little bit of a tendency towards recovery. But I think that is about a 60 percent decline. I would say it is my judgment that if we can facilitate the transfer of some capital from other industries to free the oil industry from the necessity of carrying this tremendous investment in existing producing properties by substituting some of the present oil industry capital with tax exempt capital, that we will be probably putting a lot of folks back to work. I don't know what the accurate numbers are, but a good guess would be that a 2700 decrease in rig count would result in something directly in excess of 50,000 jobs lost, not counting probably a significant percentage of that in service rigs out of work. So we are talking about not only loss of jobs, or jobs potentially being recreated through this bill, or at least going in the right direction. It isn't the point to have drilling rigs working, it is a point to be adding to the Nation's supplies of oil and natural gas, which gets us into the national defense issues and the whole business. And the industry today is desparately short of capital. We need to mobilize the capital we have within the business while letting people outside the business carry investments that are appropriate.

Mr. CAIN. Could I just respond, Mr. Chairman? Just some statistics. Apache has in particular reduced our drilling expenditures from over $70 million, Senator Long, in 1981 to $37 million, almost half the production, in 1982, and less than $25 million planned for 1983. This is consistent with the rest of the industry. In fact, we are somewhat more aggressive than even some of our colleagues are. It is imperative that these new sources of capital be available for pension funds as a clearly major potential investment.

Senator ARMSTRONG. Senator Matsunaga, do you have any statement that you wish to make or any questions for the panel?

Senator MATSUNAGA. Not at this point, Mr. Chairman.

Senator ARMSTRONG. Thank you.

Mr. Brumley, you made the point, I think, that the investment in working interest might not prove to be as prudent an investment for the institutions that we are talking about here; that they might involve a higher degree of risk. Mr. Overgaard, on the other hand, made the point that this was just in effect one more option that would be available to them. Could you elaborate a little on that? Why wouldn't it be wise in the sense that I have just described—and I hope that was an accurate paraphrase of that aspect of your testimony—why wouldn't it be wise to let the institutions themselves decide what was prudent and what was not? Why should that be a matter of tax policy? And I realize you have testified against the bill on other grounds as well. But on that question, why not let them make that decision?

Mr. BRUMLEY. Well I think if they all acted prudently then there would be no reason not to. You see many banks in the Southwest now acted imprudently on loans in the energy segment of the industry. Some of those loans they thought when they made them were good at the time. They turned out not to be as good. I used to work for an actuarial pension consulting firm, and maybe that is where some of my beliefs come from. But it was my idea at the time, and I still believe that pension funds should be invested conservatively and not in such things as wildcat oil and gas drilling. And I believe that the pension industry would best be served by not putting that capital into drilling funds. That is basically where I come from.

Senator ARMSTRONG. I don't want to pursue you too far on this, but you are not suggesting, are you, that because some banks made imprudent loans to the industry that they should be restricted by tax policy for making loans to the industry in the future?

Mr. BRUMLEY. No, sir. I didn't mean to imply that. All I was saying was that I think that pension funds are very special to this country, and that although you may have some very prudent restrictions placed on the investors and the people that work for those, still I believe that they should not be allowed to invest in very high-risk type of investments as I believe oil and gas exploration is.

Senator ARMSTRONG. I appreciate your comments. As you know, I am a sponsor of the bill. But, nonetheless, I assure you I am going to go over your statement very carefully and attempt to take into account the issues you have raised.

Mr. **Brumley**. Yes, sir.

Senator **Armstrong**. Mr. Moorhead, I want to ask one question that goes back to some testimony this morning from the Treasury. They make the observation that to really be fair this legislation should be broadened to permit tax-exempt organizations to invest in all passive investments. In effect, they say why single out this one group of investments. What do you say to that? Should we broaden the bill?

Mr. **Moorhead**. I was somewhat dismayed to read that testimony this morning. And I am not an expert on many aspects of tax, but it seems to me to be a complete non-sequitor that because there is an established industry pattern in the oil and gas business to the effect that the traditional most common way of investing is through limited partnerships which own working interest, to then say that all other industries should be allowed the same access. There is a tremendous difference. Well it really comes back to the point I tried to make earlier. It is possible today for a tax-exempt institution to invest in oil and gas ventures of any and every kind, but they may not do so through the established industry conventional formats. They have to do so through sort of jury-rigged schemes. I was looking through the Stanger Register which lists and enumerates all of the publicly registered programs. There are 30-odd programs set forth there in summary of their terms, and two of them are designed, by virtue of carving out of a working interest in net profits interest, to allow participation by an exempt institution. However, the tax aspects of an investment so carved out are not attractive or not as attractive to the conventional taxpaying investor. So you have to make a choice if you are an institution to either stay out of this business, incur the unrelated business taxable income if you want to get in it, or though you want to be in a conventional public deal, to go on a tax avoidance design deal. Those are the three alternatives. And it makes no sense to me—Treasury's line makes no sense to me to say that because you have an established thing in one industry, you should make it available for all the industries where it is not an established practice. I think they did it to push the argument, sort of ad absurdum, but I don't know their motive.

Senator **Armstrong**. Thank you. I appreciate your observations. Thank you all. We will be doing some more work on this, and we are very grateful for your input.

Mr. **Moorhead**. Thank you for the opportunity, Senator.

[Whereupon, at 2:45 p.m., the hearing was concluded.]

[By direction of the chairman the following communications were made a part of the hearing record:]

American Hospital Association

AHA

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STATEMENT OF THE AMERICAN HOSPITAL ASSOCIATION
SENATE FINANCE COMMITTEE
S.1167 AND S.1579/VOLUNTEER MILEAGE DEDUCTION

August 15, 1983

The American Hospital Association, which represents over 6,300 hospitals and other health care institutions as well as more than 35,000 personal members, is pleased to have this opportunity to comment on S.1167 and S.1579. These bills would entitle volunteers who use their automobiles for charitable purposes to a tax deduction at the standard business-use rate or the reimbursement level that federal government employees receive for official use of their automobiles. The rate for business and government employees is currently 20 cents per mile, while the mileage deduction for volunteers is only 9 cents per mile.

We wish to express strong support for both S.1167 introduced by Senator Durenberger, and S.1579, introduced by Senator Armstrong. Hospitals rely heavily on the services of over 5 million individuals who donate their time and energies for important volunteer work. These bills would significantly benefit those individuals and the institutions they serve by allowing volunteers, if they itemize their personal deductions, a reasonable deduction for travel expenses incurred in aiding these institutions. Such a change would both help to ensure the continued provision of valuable volunteer activities and provide incentives for more persons to volunteer.

Importance of Volunteers

Throughout the history of the United States, charitable contributions, both in money and kind, have been vital to the health care system. Contributions have reflected and fostered a highly desirable participatory attitude by individuals toward the health needs of their communities. Direct contributions have enabled hospitals to: replace obsolete facilities and equipment; conduct research and educational activities; maintain and improve community health care through subsidization of the cost of providing care to indigent patients; and develop and finance innovative approaches to health care delivery.

In addition, direct philanthropic support reduces the financial burden on government. For example, it has become clear that diminishing charitable support for hospitals in some urban areas has decreased their ability to maintain important patient care services. The plight of these financially distressed hospitals is now a major concern of the hospital field and the Congress. Private charitable and governmental activities in the health care field--often addressing different but related public needs and problems--are complimentary expressions of support for better health for the people of the nation. We believe the maintenance of this balance is important to the stability and improvement of the health care system.

In much the same way that philanthropic contributions complement other sources of health care financing, volunteer services complement the services provided by health care personnel. Volunteers perform services that humanize the hospital environment. They read to children and write letters for elderly patients. They also comfort patients and their families in emergency, recovery, and intensive care waiting rooms. Volunteer services are often a part of physical therapy and psychological support programs. In addition, these services have allowed hospitals to expand patient education activities related to nutrition, exercise, and natural childbirth. By escorting patients, bringing needed items to patients' rooms, and staffing gift shops, volunteers make hospital care more personal. As patient visitors, they frequently bring patients' problems or special needs to the attention of appropriate hospital personnel.

In the community, volunteers participate in health promotion and disease prevention efforts by distributing printed materials and videotapes that provide information on diseases and such risks as smoking or alcohol abuse. They also deliver hot meals to the homes of elderly and indigent citizens through the "Meals on Wheels" program. Recently, volunteers have begun community outreach programs that include health screening and referral services. If volunteer activities were to decline, many worthwhile programs would be deprived of much needed support and might cease.

Another extremely helpful volunteer service that benefits both patients and the government by preventing possible costly errors is assistance for patients who must file third-party reimbursement forms. In programs providing such assistance, a volunteer usually meets with a patient during admission to explain reimbursement procedures and may assist in completing forms prior to discharge.

Burden on Volunteers

The American Automobile Association has estimated the total cost of driving a car to be over 23 cents per mile. Other estimates range as high as 50 cents per mile. However, the volunteer mileage deduction, which became law in 1958 at 7 cents per mile, currently remains at 9 cents contrasted with the deduction of 20 cents per mile for business and government use. In 1958, gasoline 29 cents per gallon and oil was 15 cents per quart. Today, gasoline costs have skyrocketed to over $1 per gallon and oil exceeds $1 per quart. The present low rate of reimbursement in no way approximates the cost of fuel and maintenance required to operate an automobile.

The increasing cost of operating an automobile is a growing burden for persons who devote their personal resources to the performance of volunteer activities. In the interest of both local and national efforts to address community needs through private initiative, it is entirely appropriate to continue encouragement of charitable work through federal tax policy. To do so requires that the mileage deduction available to charitable volunteers equitably reflect the transportation expenses they incur through their commitment. Both S.1167 and S.1579 represent a signficant step toward this goal.

The AHA appreciates the opportunity to express its support for these bills and we will be pleased to provide any additional information that the committee may request.

American Red Cross

Office of the President

National Headquarters
Washington, D.C. 20006

August 18, 1983

Dear Mr. Chairman:

The American Red Cross and its 1.4 million volunteers strongly support and urge the passage of S. 1167 or S. 1579. The former bill would amend the Internal Revenue Code of 1954 to provide that the amount of the charitable deduction for expenses incurred in the operation of a motor vehicle will be determined in the same manner Government employees determine reimbursement for the use of their vehicles on Government business. S. 1579 would amend the Code to allow the deduction to be computed at the same standard mileage rate used in computing the business expense deduction.

The present mileage rate of 9¢ per mile allowed volunteers as compared to 20.5¢ per mile allowed Government employees and 20¢ per mile allowed business persons is grossly unfair.

For example, a Red Cross volunteer working in a hospital is allowed only 9¢ per mile to drive to and from the hospital while a salesperson calling upon the same hospital to sell medical equipment or supplies is allowed 20¢ per mile.

To cite another inequity, a Red Cross volunteer working at the scene of a disaster is allowed only 9¢ per mile to drive to and from the scene while an employee of the Federal Emergency Management Agency is allowed 20.5¢ per mile and an insurance adjuster is allowed 20¢ per mile to drive to and from the same scene.

Obviously, volunteers incur the same expense in using their personal automobiles in their charitable work as Government employees and business persons incur in using theirs in their work. Yet volunteers who give freely and generously of their time, their experience, and their compassion to help and comfort their less fortunate fellow citizens, are needlessly penalized by this unrealistic mileage allowance.

In testifying before the Subcommittee on Taxation and Debt Management on April 23, 1982, on S. 473 dealing with the automobile mileage allowance permitted for purposes of computing the charitable contribution, Deputy Assistant Secretary of the Treasury Department, David G. Glickman, said the Treasury Department opposed increasing the mileage allowance granted to volunteers. He stated, in part:

> "... The difference in the two rates results from the fact that the standard mileage rate permitted for purposes of the charitable contribution... reflects an allowance for gas and oil, that is, the expenses directly incurred in performing the charitable service... On the other hand, the standard mileage rate for business use of an automobile reflects an additional allowance for depreciation, insurance, general repairs and maintenance, and registration fee. We believe this difference is justifiable."

The American Red Cross does not believe this difference is justifiable. Moreover, many of our chapters report that this inequitable allowance granted by the Treasury Department is having an adverse effect upon the recruitment and retention of volunteers.

One wonders why a personal automobile depreciates when used for official government business or for business purposes, but not when driven by a Red Cross volunteer to a hospital, a blood donation site, a disaster shelter site, or a safety training program. One also wonders why a volunteer should not be granted a mileage allowance that includes a proportinate share of insurance premiums, as are Government employees and business persons.

To sum up, the IRS ruling is inequitable, unfair, and illogical. In these times of high gasoline prices, the ruling is imposing grave hardships upon volunteers, most of whom are persons of moderate means, on whom increasing reliance is being placed to meet pressing human service needs.

On behalf of its 1.4 million service volunteers working out of 3,000 chapters nationwide, the American Red Cross supports and urges passage of S. 1167 or S. 1579.

We request that this letter be incorporated in the record of the hearing on these bills held by the Subcommittee on Taxation and Debt Management on August 1, 1983.

Sincerely submitted,

Richard F. Schubert

Richard F. Schubert

The Honorable Robert Dole
Chairman
Senate Committee on Finance
United States Senate
Washington, D.C. 20510

Comments on S. 108, Tax Credit for Vocational Education
By
The American Society for Training and Development

The American Society for Training and Development is pleased to make comment on S. 108 on providing a tax credit for certain vocational education programs since our society represents those professionals in the workplace who primarily administer employer education and training programs and are the ultimate consumers of the vocational education product. We have nearly 50,000 members in our national organization and in the 138 chapters throughout the country. Our members provide extensive human resource development services from remedial basic education for entry-level employees to on-going job skill development for millions of employees to cope with the ever-changing needs of the workplace.

We support federal legislation like S. 108 which encourages collaboration between vocational education institutions and the private sector. We like the idea of tax incentives for employers to participate in personnel exchange programs for sharing specialized human resources for planning and instructional purposes. Some of the positive outcomes of giving employers tax incentives to collaborate with vocational education institutions include higher proficiency and achievement in training skills and knowledge; more realistic job and career expectations of students when they enter the world of work; and more efficient investment of both public and private resources.

Statement To
Subcommittee On Taxation and
Debt Management
Senate Finance Committee
August 1, 1983

by

Norman A. Sugarman
Washington, D.C.

Subject: THE NEED TO REPEAL OR REVISE IRC SECTION 4943, RELATING TO "EXCESS BUSINESS HOLDINGS" OF PRIVATE FOUNDATIONS

My name is Norman A. Sugarman. I am a partner in the law firm of Baker & Hostetler. I formerly served as Assistant Commissioner of Internal Revenue. My duties included supervising the functions of the Internal Revenue Service with respect to tax-exempt organizations. In nearly 30 years of private practice I have worked with and advised many charitable organizations, both private foundations and public charities. I am co-author of a book published by the American Law Institute-American Bar Association on the subject "Tax Exempt Charitable Organizations."

This statement is focused on Internal Revenue Code § 4943, as enacted in the Tax Reform Act of 1969. Section 4943 puts the IRS in the business of regulating, and in some cases forcing the divestiture of, holdings of private foundations in business enterprises. In my experience, this is the most troublesome - from both policy and practical viewpoints - of all the tax provisions affecting the role of charities.

I. BACKGROUND

The initial impetus for the enactment of § 4943 was the "Treasury Department Report on Private Foundations" issued in 1965. The Report concluded that the preponderant number of private foundations operated without tax abuse, but it did provide illustrations of alleged "serious faults among a minority of such organizations." Under the headings of "Foundation Involvement in Business" and "Family Use of Foundations to Control Corporate and Other Property", the Report sought to identify certain problem areas related to foundation ownership of an interest in a business enterprise. These concluded that such businesses are free from demands of shareholders for current earnings, that foundation managers' attention is diverted to business interests and/or family control, and that there are various forms of "self dealing" which arise from the relationship of the foundation with the business.

The Treasury Report recommended that a twenty percent limit should be placed on the voting interest that a private foundation may have in a business enterprise.

When hearings were held on the Treasury Report, later in 1965, comments were made on many of the different proposals contained in the Report; but with respect to the proposals relating to business holdings, the commentators were almost unanimous in their criticism of the divestiture requirements which would apply as the result of the twenty percent limit on business holdings.

When similar proposals were presented to the Congress during its consideration of the Tax Reform Act of 1969, Congressional attention was focused on two well-publicized situations, one involving the struggle between the James Irvine Foundation and Mrs. Joan Irvine Smith, a principal stockholder in the Irvine Company and the other involving what appeared to be a holding company in Texas. The impact of the divestiture requirement on many other foundations and companies did not receive the same attention. Little consideration seems to have been given to the fact that the Congress had already enacted limitations on the conduct of unrelated businesses by private foundations (which provisions were further tightened in the 1969 Act) and that in the course of development of the 1969 Act rules against "self dealing" and requiring current distributions by foundations to public charities were also enacted.

As enacted, § 4943 is very complex and the summary below can only highlight the difficulty in its application and the resulting problems which are described more fully later in this statement.

II. SUMMARY OF IRC § 4943

Private foundations and disqualified persons (including, for this purpose, certain related foundations, § 4946(a)(1)(H)) may not own together more than 20% (35% if a third person has effective control) of the voting stock of a business corporation, except as provided below for holdings as of May 26, 1969.

Holdings in excess of permitted limits which are acquired after May 26, 1969 by gift or bequest must be disposed of by the foundation within five years. Post-May 26, 1969 purchases of stock by a foundation or a disqualified person which create or increase aggregate holdings beyond permitted limits do not qualify for the five-year grace period, and may immediately result in tax penalties on the foundation. Where disqualified persons together own more than 20% (or 35%) of the voting stock of a corporation, the limitations on foundation holdings apply to nonvoting stock as well as voting stock based on value.

A general de minimis rule permits a foundation (together with related foundations) to hold not more than the greater of 2% of the voting stock and 2% of the value of all outstanding stock of a corporation. Holdings in a "functionally related business" or a business deriving 95% of its gross income from "passive sources" (both defined terms) do not constitute excess business holdings.

Similar rules apply to interests held by trusts, partnerships and other unincorporated organizations.

Holdings in proprietorships are entirely prohibited. This has the practical effect of prohibiting the conduct of an "unrelated trade or business", which public charities are permitted to do, subject to the payment of an unrelated business income tax.

Where a foundation does not reduce its business holdings to the maximum permissible limits within the required period of time, an annual initial tax is imposed on it equal to 5% of the value of the excess holdings. If the holdings are not reduced appropriately within a defined correction period, an additional tax of 200% of such value is imposed.

A "Grandfather Clause" provides special rules where the business holdings of a foundation (or a foundation and disqualified persons) exceeded the 20% (or 35%) limit on May 26, 1969. These special rules also apply to holdings acquired under trusts irrevocable on, or certain wills executed by, May 26, 1969, even though the actual ransfer to the foundation occurs later.

In general, grandfathered holdings are permitted to be retained, but are subject to reduction under certain circumstances as described below.

If, on May 26, 1969, the combined holdings of disqualified persons and the foundation exceed 50%, the holding are to be reduced over several phases. The first phase reduction periods are: 20 years where a foundation held more than 95% of the voting stock of the corporation; 15 years where the combined foundation and disqualified persons' holdings exceeded 75%; and 10 years where the combined holdings exceeded 50%. At the end of the first phase, the combined holdings cannot exceed (i) 50% of the voting stock of the corporation or, if less, (ii) 50% of the value of all outstanding shares.

After the expiration of the first phase, a second phase set of divestiture requirements become operational. If disqualified persons never own more than 2% of the corporate voting stock after the close of the first phase, the voting stock held by the foundation must be reduced to not more than 35% within an additional 15-year period. If disqualified persons do own more than 2% at any time after the close of the first phase, the stock held by the foundation must be reduced to 25%. Where May 26, 1969 aggregate holdings do not exceed 50% but exceed the 20% or 35% limits, a further decrease is generally not required if foundation holdings never exceed 25%, but may be required if there is an increase in the foundation or disqualified person level of holdings.

Grandfathered holdings are subject to reduction by operation of the "downward ratchet" rule. The rule, in effect, provides that if there is any increase in the holdings of disqualified persons, the holdings of the Foundation must be decreased accordingly and can never go up again to the former grandfathered or otherwise permitted level over 20% (or 35%), even if the holdings of disqualified persons are thereafter reduced.

III. POLICY ISSUES

In the fourteen years since the enactment of the Tax Reform Act of 1969 there has been ample time to observe the results of that Act and the time has now come to reexamine the policy and effect of certain of its provisions, particularly § 4943. In this Part of this statement, consideration will be given to the policy issues existing under the changed conditions of today; and in the next Part consideration will be given to practical problems arising from the application of the statute and corrective action that should be taken.

The following points or issues require examination to determine whether § 4943 currently represents sound policy:

A. Required Divestiture has Dried up an Important Source of Assets for Charitable Purposes.

It is generally recognized that since the 1969 Act the rate at which new foundations have been created has decreased substantially. One of the principal reasons for this decrease is that the transfer of family business holdings to a foundation (whether during life or at death) would necessitate the divestiture of such holdings (or of their control) regardless of how beneficial the holding of such assets would be to charity and the community served.

It is fundamental that no one is required to make charitable gifts; they are voluntary. When the advantages of making a charitable gift or bequest in the form of property, such as stock in a family business, are lessened, and, in fact, such a gift is made disadvantageous by reason of a government directive forcing divestiture within a fixed time, the property is not likely to be given to charity at all but rather retained in private hands. Various studies have been conducted which establish that the tax laws can create an incentive to encourage charitable gifts or can have the opposite result when the making of such gifts is rendered more difficult under the tax laws.

In 1969, Congress placed limitations on the income tax deduction for gifts of appreciated property (such as stock in a family business) to a private foundation; but § 4943 goes even further as a form of regulation by requiring the divestiture of such stock into the hands of strangers. Such divestiture penalizes gifts to the foundation not only by requiring a sale to outsiders but also because the required divestiture is likely to result in a loss in value, as in the case of any other forced sale. At a time when the country generally recognizes greater private resources are needed to be used to meet public needs, the penalizing nature of § 4943 stands out in stark contrast and as inconsistent with public policy in a pluralistic society.

B. Effect Upon Small Businesses

By its policy of forcing divestitive, § 4943 confronts the owners of businesses with the fact that maintenance of an interest in the business is not encouraged and that contribution of such interest to charity, in the form of a family or other private foundation, is discouraged.

The result is that the alternative which is encouraged is a sell-out to a larger business, generally in the form of a tax free exchange of stock.

In fact, § 4943 goes further, for if stock is contributed to a family foundation, the tax laws themselves become a vehicle to force a change in control of the business. Since there is a limit on the holdings of both "disqualified persons" and the foundation, an acquisition of stock by a dissident disqualified person can force the foundation to sell the stock, in order to avoid a penalty tax under § 4943 -- which penalty can be several times the value of the stock. Further such a sale can only be made to persons who are not family members.

Thus the owners of a business who put stock in a foundation may find that they have created the very vehicle which makes the business a takeover target. In this respect, the policy of § 4943 is in sharp contrast to the efforts of the Congress in other provisions under the tax law (most notably IRC § 6166) to ease the tax burden on family businesses so that divestiture is not required due to a tax provision.

C. The Effect Upon Community Resources, Employment and other Local Benefits

Typically, family or private foundations have been formed by individuals to fulfill a belief that wealth derived from a community should be returned for the benefit of that community. Whether this concept is entirely inspired by benevolence or is "good business", the result is the same. The foundation, which is created to hold stock in a local business and receive dividends which are distributed in support of local charities, creates in the community not only a very substantial stake in the foundation but also in the business.

In many cases, the effect of § 4943 is to threaten that community system because forced divestiture of stock is likely to place the control of a business in the hands of interests that have no ties to the community and which view the business solely from the standpoint of the bottom line. Cases have been presented to the Congress where local businesses, whether in the form of a hotel, a newspaper, or a manufacturer which is a substantial employer in the community, are faced with a threat that control will pass out of local hands and into those who do not have the same or traditional interest in the community. Certainly such results go far beyond sound tax policy or any reasonable intention of the Congress in 1969.

D. Other Rules, Already in Effect, Serve to Limit Abuses

A great deal has happened since 1969 in the regulation of the charitable field. The 1969 Act itself, by imposing penalty taxes on "self-dealing," by requiring annual distributions by private foundations for charitable purposes and by other limitations on investments and programs of private foundations have created a degree of responsibility in this field which substantially eliminates the abuses which were thought to exist in some cases in 1969. In fact, the abuses which concerned Congress have been corrected by other provisions, leaving § 4943 to serve only as an additional regulator of business operations rather than in furtherance of any sound tax policy.

Additionally, many states have strengthened their laws regarding charities and have provided additional means for their state officials to regulate foundations.

There may be other problems in the charitable field, such as those arising in connection with charitable solicitations and similar activities, but these have nothing to do with holdings of family or other private foundations and provide no basis for requiring divestiture of investments.

It should always be remembered, there are state laws, and fiduciary standards enforceable under these state laws, with respect to the responsibilities of foundation managers to use prudence in their acquisition and maintenance of investments. Moreover, the courts have been properly used over the years to enforce such standards. The issue is whether it is necessary to have the tax laws impose arbitrary limitations on investment holdings, not based on their quality but on lineage. This issue needs to be considered especially in light of the facts that divestiture may actually be injurious to the support of charity, by serving as a disincentive to creating charitable funds and by serving as a depressant on values realized for charitable purposes. Thus, the policy exemplified by § 4943 is in sharp contrast to national policy which in other respects seeks to promote private sector support for charity.

The fact that some foundations have divested themselves of certain business holdings since 1969 is not a sufficient answer. The question remains: what is the right policy now? The Congress has the responsibility to reexamine policies and to change them as needed, as it does every year in the tax and other fields.

E. Is Mandatory Divestiture Desirable?

In 1969 the Congress was asked to enact arbitrary divestiture rules so they could be applied by the administrators of the law (the IRS) without the exercise of judgment. Is this a sound policy today?

While there is much to be said for predictable administration, this does not require that convenience of the Internal Revenue Service override sound policy. It may be convenient and administratively simpler for the IRS to impose penalties based on mathematical formulas; but where sensitive matters -- such as volunteerism, community interests, support of local charities, maintenance of small business and of jobs -- are involved, then policy not mathematics should be controlling and methods appropriate to implementation of such policy should be permitted.

The tax laws reflect national policy and are designed to encourage charitable giving and the maintenance of organizations for charitable purposes. Standards already exist, under both Federal and State laws with respect to the appropriateness of maintaining certain business holdings in a charitable organization. While it may be easier for the administrators if a penalty is automatically imposed when such holdings exceed a certain fixed percent, this really is irrelevant to the issues of whether the retention or divestiture of such holdings is proper under established legal standards and whether charitable and public interests are being served.

Elimination of § 4943 and permitting the determination of whether business holdings can be acquired or maintained based on whether such action is consistent with prudent standards and charitable purposes, would provide greater overall benefit than the present arbitrary standards. As previously indicated, there are already other penalties under the tax laws which provide the IRS ample tools for curbing any true abuses.

Summary of Basic Policy Considerations

The foregoing policy considerations require that Congress reexamine § 4943 and determine whether the price being paid for regulating business holdings of foundations is too great in light of the need for charitable support, maintenance of local businesses and the preservation of community resources in the public interest.

While the cost of the existing policy to communities and the public can be demonstrated on a case-by-case basis, the Congress should recognize that the cumulative effect is to establish that there is a need to permit charitable foundations to acquire or hold investments where that can be justified under prudent standards and in the public interest. The dictates of fourteen years ago should not blind the Congress to the need for a more enlightened policy which recognizes the importance of generating support for community interests from the private sector.

If § 4943 is repealed and abuses appear in the future, the Congress can then take proper corrective action. In the meantime, the creation and development of charitable foundations should be encouraged, not discouraged.

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STATEMENT OF HOUSTON ENDOWMENT INC.

HOUSTON, TEXAS

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
COMMITTEE ON FINANCE
U. S. SENATE

HEARING ON S. 1464

HELD AUGUST 1, 1983

SUBMITTED AUGUST 15, 1983

This statement is submitted for the record on behalf of Houston Endowment Inc. of Houston, Texas in response to the hearing on S. 1464 held on August 1, 1983 by the Finance Subcommittee on Taxation and Debt Management.

S. 1464 represents one solution to the divestiture problem presented by I.R.C. of 1954 §4943. The problem presented by §4943 is also of major concern to Houston Endowment Inc. Agreeing with the concept of S. 1464 that I.R.C. of 1954 §4943 should be repealed or overriden in certain instances, this statement presents a discussion of the problems caused by §4943 and a discussion of a legislative solution to the problem currently being considered in the U. S. Senate.

HOUSTON ENDOWMENT INC. - GENERAL INFORMATION

Houston Endowment Inc. ("Endowment") was organized in 1937 by Jesse H. Jones and his wife, Mary Gibbs Jones. Mr. Jones is best remembered for his services during the Franklin D. Roosevelt administration as Secretary of Commerce and as head of the Reconstruction Finance Corporation.

Prior to his death in 1956, Mr. Jones pursued a policy of making substantial annual gifts to Endowment, and Endowment was named as principal beneficiary in his will.

A large portion of Endowment's activity has been in the field of education, and major emphasis has been placed on the establishment of scholarships in colleges and universities throughout the United States. This has been done in two ways. First, Endowment has established scholarship programs with a number of colleges and universities. These institutions assume responsibility for administering the scholarships, including determining the amount of each scholarship and the recipient of each scholarship. Second, Endowment inaugurated a program in 1958 which has continued to this date involving an arrangement with the Houston Independent School and contiguous school districts and private parochial schools whereby such school districts and schools make nominations from their graduating high school students. An impartial group of substantial citizens, not connected with Endowment, choose the scholarship winners on the basis of achievement, economic need and leadership potential. Scholarship winners are not restricted as to the subject in which they may major, and they may attend any accredited college or university of their choice in the United States. Since the inception of this one program, 3,382 students have received scholarships and have attended over 241 colleges and universities. 597 college students are attending college on such Jones scholarships on this date. The scholarships granted under this program since its inception aggregate $9,725,500.00 as of December 31, 1982.

Endowment has made many educational, charitable, cultural, medical and civic grants. The following is a short, partial listing to illustrate the scope and nature of them:

The Museum of Fine Arts, Houston	
Contribution, Exhibition Endowment Fund	$3,101,000
The Museum of Natural Science, Houston	
Building Addition	1,500,000
Rice University, Houston	
Scholarships and Gift of Real Property	6,981,915
Establishment of Graduate School of Administration	6,500,000
Endowed Scholarship Program (since 1978) for 25 Private Texas Colleges	4,650,000
The University of Texas at Austin	
To Endow College of Communication	5,000,000
University of Notre Dame	
Professorship in Management, Annual Contribution	100,000
Faculty Research Fund	1,000,000
Texas Christian University, Fort Worth	
Library Building	500,000

Moody House, Inc., Galveston, Texas Home for Aged, Gifts of Real Property	5,720,000
Jewish Community Center, Houston Purchase of Campsite in Fort Bend County	325,000
Union y Progresso Barrio Development Inc., Houston Neighborhood Medical Clinic and Senior Citizens Center	1,103,608
Eliza Johnson Home for Aged, Houston Capital Funds and Support of Program	445,000
The Arthritis Institute of The National Orthopedic and Rehabilitation Hospital, Arlington, Virginia Fellowship Endowment	200,000
Hermann Hospital, Houston Completion of 8th and 9th Floors and Establishment of Texas Kidney Institute	6,300,000
Texas Tech University, Health Science Center, Amarillo, Texas Scientific Research Library in Amarillo Medical Center	250,000
Texas Heart Institute, Houston Expansion of facilities	2,000,000
Southwestern University, Georgetown, Texas Construction and Rehabilitation of Educational Properties	5,000,000

As of December 31, 1982, Endowment's grants for educational, charitable, cultural, medical and civic purposes aggregated $214,315,674.30.

Attached is a tabulation covering the past six years, showing the fair market value of Endowment's assets for each year, and the Distributable Amount and Qualifying Distributions, all as reported by Endowment to the Internal Revenue Service. The 1982 figures are estimated.

RECOMMENDED CHANGES IN EXISTING LAW

Endowment is the owner of all of the capital stock of Houston Chronicle Publishing Company, a Texas corporation, which publishes the Houston Chronicle, a daily newspaper of general circulation in Houston and surrounding areas.

In 1969, Section 4943 was added to the Internal Revenue Code. The general effect of this Section is to require a private foundation (as defined in Section 509 of the Code) to dispose of its ownership in the assets or stock of any "business enterprise" (as defined in Section 4943) within a specified period of time. Exceptions contained in Section 4943 permit a private foundation and its "disqualified persons" (as defined in Section 4946) to continue to own up to 20 percent of the assets or stock of a business enterprise in the aggregate (or, in the case of a business enterprise owned by the foundation prior to May 26, 1969, up to 50 percent in the aggregate).

As a result of Section 4943, all private foundations will be prohibited after May 26, 1989, from owning more than 50 percent of the assets or stock of any business enterprise owned by them on May 26, 1969. In addition, Section 4943 will prohibit private foundations from owning over 20 percent of the assets or stock of any business enterprise acquired since May 26, 1969.

Endowment recommends to the Subcommittee that Section 4943 be amended to permit the private foundations which presently own interests in certain daily newspapers to continue that ownership. There are several compelling reasons why this should be done:

First, the divestiture requirements and penalty tax provisions of Section 4943 violate the provisions of the First and Fifth Amendments to the Constitution of the United States.

The operation and publication of a newspaper represent the quintessential exercise of the First Amendment freedoms of speech and press. Section 4943 imposes a direct restraint upon these First Amendment freedoms of Endowment by forcing it to relinquish its First Amendment right to own and operate the Houston Chronicle Publishing Company. The Constitution of the United States requires that all persons or groups be treated equally in their exercise of these First Amendment freedoms, unless some compelling governmental interest which cannot be achieved by any other means necessitates that they be treated differently. The United States Supreme Court has on many occasions, and most recently in Minneapolis Star & Tribune Co. vs. Minnesota Commissioner of Revenue, _____ U.S. _____, 51 U.S.L.W. 4317 (March 29, 1983), ruled that the government may not "tailor a tax so that it singles out a few members of the press . . ." for disfavored treatment. A tax that "targets individual publications within the press places a heavy burden on [the government] to justify its action." Such a statute, in the Court's words, is "presumptively unconstitutional." A governmental action which restricts the activities of a certain group of newspapers in order to protect other newspapers from competition runs afoul of these First Amendment principles. Section 4943 and other provisions of the Internal Revenue Code, by denying Endowment either direct or indirect access to the public, leaves it without any means to exercise its freedoms of speech and press. This deprives the public of a source of information and ideas. The policies of the First Amendment, which favor the free flow of ideas and the widest possible dissemination of information from diverse and antagonistic sources, require that alternatives be adopted to achieve the taxing goals of Section 4943 which would impose a lesser restriction on the rights to free speech and press of Endowment and other private foundations.

Additionally, the equal protection component of the due process clause of the Fifth Amendment to the Constitution demands that classifications which restrict the exercise of fundamental First Amendment freedoms must be necessary to promote a compelling governmental interest. Section 4943 applies to private foundations operating a functionally unrelated business enterprise, but not to any other organization. For example, the statute does not affect those newspapers or businesses owned by other tax-exempt entities. The different treatment given these groups in many respects goes beyond that necessary to achieve the congressional objectives of the statute. Also, the statute fails to apply to all the businesses which present the problems Congress sought to control. The Constitution's guarantee of the equal protection of the laws would be better served if alternative means were adopted to pursue the taxing goals of Section 4943 which would impose a lesser restraint upon the rights of freedom of speech and press.

There is submitted herewith a legal brief providing a complete analysis of Section 4943 under the First and Fifth Amendments.

Second, divestiture of the Houston Chronicle will most likely cause the newspaper to no longer be a locally owned independent newspaper, which is not in the national interest. Federal and state laws generally require managers of private foundations and executors of estates to obtain the highest available price for assets sold. Recent history has repeatedly demonstrated that the highest bidders for independent newspapers are the national and international newspaper chains, thereby vesting in the hands of fewer and fewer persons the power to control the reporting and editorial policies of more and more newspapers. This concentration of power is a matter of concern to Congress and the Federal Trade Commission and has been the subject of Congressional hearings, particularly hearings held during May, 1979, by the Committee on Small Business, U. S. Senate, which inquired into "Economic Concentration In The Media -- Newspaper." During such hearings, Mr. Alfred E. Dougherty, Jr., Director, Bureau of Competition, Federal Trade Commission, made the following statements:

> Between 1910 and 1976, the number of newspaper chains rose from 13 to 167, and the number of chain-owned dailies rose from 62 to more than 1000. The percentage of circulation held by those chain-owned papers rose from 43.4 percent in 1930 to 71 percent in 1976.

Conversely, in that same period, the number of independently-owned newspapers dropped from over 97 percent of the total number of dailies to less than 41 percent. This means that there are now fewer than 900 remaining independent daily newspapers in this country.

These changes have been accompanied by a marked decrease in the number of newspapers which face direct competition from other daily metropolitan newspapers. In 1923, nearly 39 percent of the U. S. cities had more than one independently-owned daily newspaper. By 1973, this figure had dropped to less than 3 percent. In absolute numbers, there were 502 cities with two or more daily newspapers in 1923; by 1973, this number had dropped to 37.

Although the number of chain-owned dailies has increased dramatically, so has the number of newspaper chains. As noted, in 1919 there were 13 newspaper chains; by 1976, there were 167."

Attached is a copy of an article appearing in the September, 1979, issue of Editor and Publisher giving further information with regard to the growth of the newspaper chains. Based upon information compiled by the American Newspaper Publishers Association showing all newspaper sales and acquisitions in the United States for the period 1975-1981, it appears that over 92 percent of the sales and acquisitions occurring during such period were to or by newspaper chains or foreign buyers.

To insure the continuation of a broad-based, independent, free press in the United States, the policy of Congress should be to encourage (rather than discourage) the ownership of independent local newspapers throughout the country.

Under current law, continued ownership of independent newspapers is made virtually impossible. If the newspaper is owned by a private foundation, Section 4943 mandates its sale. If the newspaper is owned by an individual, payment of the Federal estate tax obligations incurred upon the death of the principal owner or his or her spouse necessitates sale.

Concern about concentration with respect to the newspaper industry exists throughout the world. The Canadian government has expressed concern about this and has announced that it plans legislation to limit holdings of newspaper chains. Such concentration is aggravated by the number of newspaper failures, notably in Washington, Philadelphia, New York, Denver and elsewhere in this country, as well as highly publicized failures in London and other parts of the world. The fact of the matter is that independent daily newspapers are fast diminishing. Only 538, or 31 percent of the 1973 U. S. dailies are independent, according to information compiled by the American Newspaper Association Membership Department. The rest are members of groups in which two or more newspapers in different communities are under common ownership.

S. 1410, sponsored by Senators Bentsen, Tower, Symms, Byrd, Heflin, Hollings, Thurmond and Denton, provides that a private foundation may continue to own a local, independent newspaper.

S. 1410 offers an additional advantage in that it would encourage an individual who owns controlled interest in a newspaper to bequeath his interest in such newspaper to a private foundation since ownership by the private foundation would continue local ownership and control and would permit the donor, by devoting the newspaper to charity, to place it in the hands of the managers of the Foundation for future management. Accordingly, the bill offers an attractive alternative to some who would otherwise be required to sell in order to pay federal estate taxes.

A third compelling reason for continuation of ownership of this newspaper by Endowment is the total absence of revenue lost to U. S. government.

It should be noted that if S. 1410 becomes law, a private foundation owning a newspaper would continue to be subject to the requirements of Section 4940 (excise tax on investment income), Section 4941 (tax on self-dealing), Section 4942 (tax on failure to distribute income), Section 4944 (tax on jeopardy investments), and Section 512 (tax on unrelated business income), the combination of which would effectively insure against the newspaper being operated for any personal gain or other improper purpose. Further, under existing law such newspaper is subject to the same income taxes as a newspaper which is owned by an individual or a corporation.

Finally, there would be no competitive unfairness if S. 1410 were enacted.

The legislative history of the stock ownership limitation with respect to private foundations adopted by Congress in 1969 reflects that one of the paramount considerations for the legislation was a desire to prevent a competetive disadvantage between businesses operated by foundations and those operated by private individuals, the thought being that individuals managing businesses operated by foundations tend to devote an unreasonable amount of earnings to the enhancement of plant, equipment and personnel and do not give the same attention to realization of profit as a privately owned competitor.

The Houston Chronicle has as its principal competitor in the City of Houston the Houston Post, a morning daily newspaper. The ownership of the Houston Chronicle by a private foundation has not adversely affected the Houston Post, as is reflected from a comparison of the following figures:

I. Total Advertising Linage (Source: Media Records, an independent advertising measurement firm):

	Total Advertising Linage	Market Share	National Ranking
1965			
Chronicle	53,489,842	56%	8
Post	41,219,214	44%	Not in top 10
1982			
Chronicle	114,275,040	58%	2
Post	81,680,199	42%	9

II. Total Paid Circulation (Source: Publisher's Statement to the Audit Bureau of Circulation, an independent circulation auditing firm):

	Daily	Saturday	Sunday
1965			
Chronicle	277,488(51.9%)	256,121(49.1%)	317,597(53.2%)
Post	257,277(48.1%)	265,018(50.9%)	297,104(46.8%)
Sept. 30, 1982			
Chronicle	419,869(52.7%)	410,155(50.5%)	502,654(53.5%)
Post	376,455(47.3%)	401,185(49.5%)	436,659(46.5%)

Although, as the foregoing figures clearly reflect, there has been no significant deterioration in the competitive position of the Post as against the Chronicle, there is included in S. 1410 a provision to the effect that any private foundation owning an independent local newspaper covered by the bill would benefit from the provisions of the bill only as long as such newspaper is operated in accordance with standards of efficiency and profitability prevailing in the newspaper industry in the United States from time to time. Surely such a provision will provide adequate assurance to Congress and protection to the Houston Post.

Houston Endowment has established a long, proud and economically significant tradition of charitable endeavors. With retention of the Houston Chronicle (as permitted in S. 1410), this tradition would be strengthened at a time when the federal government has reduced its role, compelling all other enterprises to do more to make the advantages of America available to all. S. 1410 preserves and encourages a constitutionally free, independent local newspaper at no revenue lost to the Government and should be adopted.

HOUSTON ENDOWMENT INC.
HOUSTON, TEXAS
E.I. #74-6013920

INFORMATION FROM TAX RETURN OF PRIVATE FOUNDATION, INTERNAL REVENUE SERVICE FORM 990-PF PER YEAR	1977	1978	1979	1980	1981	1982*	SIX-YEAR TOTAL
MARKET VALUE OF ASSETS AT YEAR END	$251,038,803	$243,309,021	$234,352,367	$242,399,169	$234,929,213	$270,000,000	
DISTRIBUTABLE AMOUNT							
Adjusted Net Income	$ 11,273,387	$ 13,837,194	$ 14,026,317	$ 13,535,802	$ 20,500,201	$ 20,406,349	
Minimum Investment Return (Part VIII, Line 6)	11,986,379	12,381,737	13,003,322	12,234,336	12,962,172	13,297,900	
Excise Tax on Investment Income	(366,066)	(589,860)	(279,834)	(229,062)	(711,878)	(400,000)	
Income Tax on Unrelated Business Income	-	-	(807)	-	-	-	
	$ 11,619,313	$ 13,247,334	$ 13,745,776	$ 13,306,740	$ 19,788,323	$ 12,897,900	$ 84,605,386
QUALIFYING DISTRIBUTIONS							
Grants Paid	$ 12,561,219	$ 12,397,956	$ 13,638,464	$ 13,380,407	$ 18,817,196	$ 18,763,336	
Allowable Administrative Expenses	331,644	285,426	302,441	279,027	314,532	325,000	
	$ 12,892,863	$ 12,683,382	$ 13,940,905	$ 13,659,434	$ 19,131,728	$ 19,088,336	$ 91,396,648

*Form 990-PF for year 1982 has not yet been filed, and calculation of actual amounts to be entered on return has not been completed. Accordingly, the amounts reported on the return when filed may vary slightly from the estimated information shown.

E&P
Every Saturday since 1884

Senate panel is told why newspaper groups continue to grow in the U.S.

Golden Dozen to Baker's Dozen—there are now 13 newspaper groups in the United States that qualify for membership in the millionaires' club (those whose aggregate weekday circulation exceeds one million copies).

These 13 groups (or "chains" as they are called in congressional hearings and academic treatises) had ABC-certified weekday sales of 26.268.955 copies and Sunday sales of 27.529.095 as of September 30, 1978 audits. The totals represent about 42 percent of U.S. daily circulation and 50% of Sunday circulation. Group newspapers have been responsible for a large part of the upward surge in Sunday circulation by adding scores of Sunday editions.

In this annual compilation based on statistics in the *1979 Editor & Publisher International Year Book*, the Knight-Ridder group holds its place as No. 1 in aggregate circulation with 34 dailies in 25 markets. Gannett became a close second, the merger with Combined Communications Corp. adding two major papers—*Oakland Tribune* and *Cincinnati Enquirer*—for a total of 80 in 68 markets.

Also in the 3-million class, Newhouse Newspapers (29 in 22 markets) was not far behind Gannett nor was the Tribune Company (9 in 9 markets). Acquisition of the *Hartford Courant* moved Times-Mirror over the 2-million mark.

Eleven groups have aggregate weekday circulation of more than 500.000 copies. They are:

Pulliam in four markets.
Copley in eight markets.
Evening News (Detroit) in four markets.
Freedom in 30 markets.
Harte-Hanks in 22 markets.
Independent (McLean et al) in four markets.
Lee in 21 markets.
Media General in four markets.
Murdoch in two markets.
Washington Post in three markets.
Landmark in eight markets.

One aspect of newspaper ownership is attracting greater attention by advocates of legislation to curb monopoly. That is the extent to which the Newspaper Preservation Act of 1971 provides anti-trust exemption in group newspaper business operations. Of the 20 situations where joint arrangements are protected, group owners are partners in 16. Gannett Company recently acquired controlling interest in the printing corporation by switching from the Banner to the Tennessean in Nashville.

The four situations where both partners in the joint plant operation are local independents are in Fort Wayne, Ind., Tulsa, Okla., Franklin-Oil City, Pa. and Salt Lake City, Utah. Gannett is a partner with non-group papers in Honolulu, Shreveport, La. and Nashville; with Pulitzer in Tucson and with Scripps-Howard in El Paso. An application for approval of a Gannett-Scripps tieup in Cincinnati has been before the Department of Justice for more than a year.

Scripps-Howard is involved in six partnerships—Pittsburgh (with Block), Albuquerque (with a non-group owner), Columbus, O. (with a non-group owner), Knoxville (with non-group owner), Birmingham (with Newhouse) and El Paso (with Gannett). Newhouse and Pulitzer have a joint operation in St. Louis. Hearst and an independent have a joint arrangement in San Francisco. Lee and independents share plants in Madison, Wis. and Lincoln, Neb. Knight-Ridder and Cox have a joint arrangement in Miami and Clay operates with an independent in Charleston, W. Va.

A review of the Newspaper Preservation Act (originally called the Failing Newspaper Act) would be an item on the agenda of a government commission which Rep. Morris K. Udall of Arizona proposes to study the level of competition in publishing and other industries. Sen. Gary Hart of Colorado and Sen. Larry Pressler of South Dakota are co-authors with Udall of the Competition Review Act authorizing a five-year study. A similar bill, providing for a three-year study, failed to attract much support in the last Congress.

Millionaires' Club

Group	No. of dailies	Circulation Weekday	Circulation Sunday	No. of markets
1. Knight-Ridder	34	3,732,191	4,347,532	25
2. Gannett	80	3,390,135	3,396,253	68
3. Newhouse	29	3,229,320	3,302,888	22
4. Tribune	9	3,158,220	4,312,919	9
5. Times Mirror	7	2,061,467	2,484,528	7
6. Dow Jones	21	1,946,448	325,840	21
7. Scripps-Howard	17	1,898,440	1,553,644	16
8. Hearst	10	1,442,992	2,195,716	9
9. Cox	19	1,295,382	1,263,420	13
10. Thomson	64	1,076,717	640,882	64
11. Cowles	10	1,025,237	1,392,121	8
12. Capital Cities	8	1,010,012	744,266	5
13. New York Times	10	1,002,393	1,569,092	10

The trend toward group purchases of family-owned independent newspapers continues this year, according to the number of sales reported in E&P. In seven months of this year 38 daily newspapers changed hands and 34 of them have gone into groups. They include five dailies of the Lindsay-Schaub group that went to Lee Enterprises and two Carter Glass properties that joined the Worrell list.

So the actual number of groups has declined from 167 in 1978 to 164 this year. A group, by E&P definition, is composed of two or more dailies in different markets under common ownership.

In current transactions three notable family enterprises have been transferred to wide-ranging groups. They are the *Buffalo* (N.Y.) *Courier Express*, the Conners family's morning-Sunday paper bought by the Cowles interests of Minneapolis and Des Moines; the *Nashville Tennessean*, morning-Sunday, which Gannett takes over from the Evans family in a deal which puts the *Nashville Banner*, evening, into the hands of a local group; and the *Hartford* (Conn.) *Courant*, morning-Sunday, for which Times-Mirror Company of California is paying about $105 million to a large number of shareholders. The Courant price, incidentally, tops the amount paid by Capital Cities Communications Inc. for the *Kansas City Star* and *Times*—$96 million after divesting two paper-making concerns—in 1977.

This year's transactions have focused attention on the growth of groups in one state—Florida. The purchase of the *Winter Haven News-Chief* by Multimedia Corp. left only six dailies out of 41 in local ownership. Multimedia became the 14th "national" group to own a daily newspaper in Florida.

Meanwhile, in Washington, the staff of the U.S. Senate

(Continued on page 14)

Newspaper groups continue to grow

(Continued from page 9)

Select Committee on Small Business has been considering the question of how much longer a 25,000-circulation daily such as the *Salisbury* (N.C.) *Post* might resist tempting offers from a group and remain a family operation.

Third-generation publisher James F. Hurley III told his answer to that question in a document which is a part of the thick file of testimony recorded by the committee. In December, the chairman, U.S. Senator Robert Morgan of North Carolina, has promised a full report to the public on what it has learned about the state of the newspaper industry and what could be done by legislation to stem the tide toward concentration of ownership of the free press.

Morgan opened the special inquiry declaring that "there appears to be more misinformation than good information." He wanted to know, he said, what is the makeup of the newspaper industry . . . what is the government position regarding it . . . how do the chains operate and carry out editorial policy . . . when does concentration of ownership become a true threat to freedom of the press . . . and what is the state of competition between the newspapers and other communication media.

"Many people who wish to start papers are small businessmen and these hearings will better acquaint them with the possibilities and pitfalls," Senator Morgan remarked. "Many small businessmen enter the newspaper business with the intention of selling out to a chain at some point and then retiring. Many do not and wish to pass the paper on to their children but find they cannot."

Jim Hurley, whose family has owned the Salisbury Post since 1912, provided the committee with a factual—though hypothetical—case history of two newspapers (*Family Times* and *Family News*), one of which was sold to a group. His presentation to the committee follows, in part:

Newspaper A (Family Times) has circulation of 25,000 and does a business of $3 million per year. Its advertising rate is $2 per inch and its subscription price is $4 per month. (These figures are very low).

Out of its operating revenues, Family Times earns 20 percent or $600,000 before taxes. The owners of the community paper elect to put 10 percent of pre-tax profits into a profit-sharing plan for employes and 5 percent into local charities, etc. Thus the taxable revenue is about $500,000, half of which is left for the owners.

Internal Revenue Service has "strongly recommended" that the company pay half of its net earnings in dividends because it can't prove a need for retaining much more than the allowable $150,000. Family Times, IRS says, is not using its retained earnings to buy other newspapers so it can't justify more than $1 million in retained earnings.

Thus only $125,000 is paid in dividends to owners who have other income and find themselves in the 60 percent tax bracket. Therefore, $75,000 of the dividends from the newspaper go to pay federal income taxes, leaving the five owners $50,000 to share.

The press, purchased 10 years ago for $500,000, cannot be replaced for $500,000 allowed as depreciation. A new press of the same capacity would cost $2 million. Thus, Family Times must set aside all of its undistributed profits for 12 years merely to replace the press.

Meanwhile, Newspaper B (Family News) is located 20 miles down the road. It also has a circulation of 25,000, an advertising rate of $3 per inch, and a subscription price of $4 per month, and annual revenues of $3 million. It has 20 owners, all descendants of the original owner. Ten still live in town, but 10 have scattered to various parts of the country.

Disgusted with their return of $2,500 in after-tax dividends (50,000 divided by 20), the out-of-town nieces, nephews and cousins demand more money. Family News has its annual stockholders meeting and faces three options:

1. It can operate as it always has operated, paying some dividends and investing the remainder in new equipment and in its employes and its community.
2. Tighten up by eliminating any investment in employe benefits (i.e. profit sharing) or the community or in saving its profits for re-investment and thus, pay out all after tax earnings in dividends. This pleases, at least temporarily, the cousins but management realizes it will take its toll in efficiency as each year goes by.
3. Sell the paper for $20 million to Group Communications, Inc.

After much heated debate, the stockholders decide on Option 2. Fewer benefits for employes. Little community involvement. No money set aside to replace equipment.

Soon Family News realizes it has made a disastrous choice. Employes, not having the advancement opportunities on a single paper they have on a group newspaper, demand more money and security for the same jobs. The community feels the newspaper no longer helps with worthwhile causes and thus the paper loses some key support. Most importantly, Family News' press begins breaking down more and more often. Its production equipment begins to be outmoded. Its profits begin to dip, and Family News must make a huge investment to remain profitable. Since money has not been set aside to replace this equipment, Aunt Susie in San Francisco must come up with an investment of $200,000 or go on a note of that amount as her share to keep the paper profitable. Other stockholders must provide an equal amount.

The Family News, whether it decides on Option 3 immediately or delays sale by taking Option 2, sooner or later will get around to Option 3, i.e. selling the paper to Group Communications, Inc.

How can Group Communications, Inc., profit by paying $20 million for the Family News?

Group Communications, Inc., borrows $20 million to pay to stockholders of Family News. This costs Group Commo $2 million per year in interest. Therefore it is tax deductible if Group Commo can make a before tax profit of $2 million in Family News, which we shall now call Group News.

Group Commo, Inc., noting that the advertising and circulation rates are extremely low, raises the advertising rate 50 percent to $3 an inch and the subscription rates to $6 per month. Group News now has an income of $4.5 million versus the old Family News' income of $3 million. (Because of the increase, some customers quit initially but Group Commo finds some efficiencies, so the changes balance out.)

Since Group Commo, Inc., does not improve the paper materially, other than through its own expertise, expenses of Group News remain the same as that of the old Family News. As a result, Group News earns $600,000, plus all the increase in revenues brought in by the rate increases. Income becomes $2.1 million before taxes, not $600,000.

Group Commo Inc., the parent company, will pay off the principal either out of its 50 other profitable newspapers, the profits over and above the $2 million interest and/or with inflation. Taxes, because of interest expense, are zero.

Meanwhile, what happened to the 20 owners? Each received $1 million from the sale. Let's say capital gains cost 25 percent or $250,000 for each of the stockholders. Each one received $750,000 after tax. He invests the money in tax-free bonds at 6 percent. Aunt Susie's income now is $45,000 after each tax year instead of $2,500. Why shouldn't she sell?

Group Communications Inc., taking advantage of legislation which saves the company money, operates Group News very efficiently. It may even make improvements because corporate headquarters can supply experts in everything.

STATEMENT OF
INTERNATIONAL UNION, UNITED AUTOMOBILE, AEROSPACE AND AGRICULTURAL IMPLEMENT WORKERS OF AMERICA (UAW)

on the

UNEMPLOYMENT COMPENSATION EXTENDED BENEFITS PROGRAM

Submitted to the

SUBCOMMITTEE ON
SOCIAL SECURITY AND INCOME MAINTENANCE PROGRAMS
of the SENATE FINANCE COMMITTEE

August 1, 1983

The UAW is pleased to present its views on the changes in the Extended Benefit Program enacted under the Omnibus Budget Reconciliation Act of 1981.

The Omnibus Budget Reconciliation Act instituted severe eligibility restrictions for the 13 additional weeks of benefits available under the Extended Benefit Program to exhaustees of regular state benefits. This legislation drastically cut back on eligibility by:

(a) eliminating the national trigger;

(b) excluding extended benefit recipients from the calculation of the state extended benefit triggers;

(c) requiring a 20 to 25% increase in the state extended benefit triggers (by raising the necessary targets by one percentage point);

(d) requiring twenty weeks of work for extended benefit eligibility.

These changes have led to sharp cutbacks in budget outlays, but at the expense of several million unemployed workers. If not for the first two changes, extended benefits would have been paid in all states beginning in May 1982, nearly one year after the onset of the recession. Exhaustees of regular state benefits in many states had to wait until mid-September to receive additional weeks of benefits under the Federal Supplemental Compensation program.

The impact of these legislated changes on workers in the hardest hit states has been even more devastating. In the midst of severe unemployment, the Extended Benefit Program triggered "off" in Michigan between December 1981 and March 1982; the State's unemployment rate of 12% was then the highest in the country. This unfortunate situation was nearly repeated this past winter as the State's insured unemployed rate fell below the 6% threshold for the four weeks immediately preceding the effective date of this higher trigger. Fortunately, the combination of an increase in regular state benefit recipients and a decline in the number of covered workers pushed the State's thirteen-week insured unemployment rate just barely above 6%. In nine other states,[1] however, extended benefit payments were suspended last October as the higher threshold requirements came into effect.

Though the economy is beginning to emerge out of its deep recession, the problem of high joblessness will not dissipate for many months and even years to come. Moreover, the cutbacks in the Extended Benefit Program are continuing to inflict suffering on the long term unemployed. The National Bureau of Economic Research recently pronounced that the 1981-82 recession bottomed out in November 1982 while the official unemployment rate peaked at 10.8% in December. The stock market has been predicting a recovery since last summer, and indeed wealthy investors and brokerage firms have been reaping huge gains over the last year. Unfortunately, millions of unemployed workers have yet to see or feel the end of recession.

The unemployment statistics point to nearly 11.6 million workers without jobs in June, including 2.8 million who were jobless for 27 weeks or more. In June 1981, the last month before the recession began, total unemployment was less than 8.5

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[1] Alaska, Arizona, California, Louisiana, Montana, Nevada, North Carolina, Rhode Island, and Utah.

million, with 1.1 million long term unemployed. In addition to the 11.6 million workers counted as unemployed, another 6.6 million were working on a part-time basis and were interested in full-time work, and another 1.6 million were too discouraged to even search for jobs. On a seasonally adjusted basis, the civilian unemployment rate dropped to 10.0% by June, down from last December's post-depression record of 10.8%. However, unemployed workers are now jobless for an average of 22.0 weeeks, up from an average of 14.3 weeks in June 1981. Half the unemployed in June were jobless for 11.8 weeks or longer, compared to an average of 6.7 weeks two years earlier.

While the President declares that the economy is "beginning to sparkle," the Administration's own forecasts for 1983-84 project a 9.6% unemployment rate for the last quarter of 1983 and an 8.6% rate for fourth quarter 1984. Full employment, newly defined at 6% in an exercise of statistical obfuscation, is not projected until the end of 1988, and even that forecast is considered too optimistic by some observers (see The Morgan Guarantee Survey, July 1983).

In the midst of current high joblessness and projections of continued unemployment problems we find that exhaustees of regular state benefits are currently eligible for extended benefits in only five states (Alaska, Louisiana, Pennsylvania, West Virginia, and Wyoming), with three of these states slated to terminate extended benefit payments as of August 6. Twelve other states with unemployment rates in excess of 10% (May, latest available) have already triggered off the program (see appended table). This is for a program set up to provide additional weeks of benefits during periods of high unemployment. In Michigan, the total unemployment rate stood at 14.7% in May; yet 56,000 unemployed workers were dropped from the extended benefit program in mid-June when it triggered off. In Indiana, the EB program triggered off at the end of April and the insured unemployment rate has since dropped to 3.6%. Yet, the total unemployment rate reached 10.2% in May. Unemployed workers in three states (Arizona, New Mexico, Tennessee) with current unemployment rates in excess of 10% have been denied extended benefits since the last quarter of 1982. In Tennessee, for example, the total unemployment rate stood at 11.3% in May, yet the insured rate is now less than 3.6% and extended benefits have been triggered off since the last week of September.

The cutbacks in the Extended Benefit Program have led to severe economic hardship for several million workers who have exhausted regular state benefits and/or federal supplemental benefits, and have been denied extended benefits. As a result, the nation's record for cushioning the impact of joblessness has been far worse during this recession than in any other postwar downturn. Even with the additional benefit weeks under the Federal Supplemental Compensation legislation, no more than 40% of the nation's unemployed currently are receiving any unemployment benefits; during the 1974-75 recession, by contrast, nearly three-fourths of the unemployed were receiving benefits.

The more adequate protection afforded unemployed workers in prior years was the product of more reasonable standards for the payment of extended benefits and the enactment of programs to protect exhaustees of extended benefits as well. During the two recessions of the 1970s, for example, legislation was enacted to extend unemployment benefits for durations of as long as 65 weeks. Between January 1972 and March 1973, benefits were extended for an additional 13 weeks, up to a maximum of 52 weeks. Benefits became payable for an additional 13 weeks to exhaustees of extended benefits between January and March 1975, for 26 additional weeks (up to 65 weeks) between March 1975 and March 1977, and for 13 additional weeks (up to 52 weeks) until January 1978. The 13 additional weeks of potential benefits payable between April 1977 and January 1978 were financed by general revenues.

The cutbacks instituted under the Omnibus Budget Reconciliation Act violated the purpose of the federal-state unemployment insurance system, which was established in the mid-1930's in recognition of the enormous costs borne by unemployed workers as a result of economic, political, and social forces over which they have no control. Two major goals were set: first, to cushion workers against economic hardship when they become unemployed through no fault of their own; and second, to bolster purchasing power when total spending is declining, thereby helping to automatically stabilize an historically cyclical economy. The two goals are closely related — an adequate level and duration of benefits are required to ease private adversity and bolster a community's total purchasing power during periods of economic decline and high unemployment.

The legislated changes have seriously weakened the program and its role as a first line of defense against the hardships brought about by rising unemployment. Not only have unemployed workers and their families suffered by the shredding of the already threadbare safety net provided by the unemployment insurance program, but businesses have suffered as well due to the rapid shrinkage of purchasing power in their communities. The number of unemployed workers exhausting their regular state benefits exceeded 400,000 per month in the first five months of this year, and only a small percentage of these exhaustees live in states paying extended benefits.

The costs arising from unemployment and the exhaustion of benefits are being borne privately in the homes of the unemployed; these costs range from financial insolvency, mortgage foreclosures, and the inability to pay for urgently needed medical care to the rise in intra-family tensions and mental health problems. The costs also are being borne socially as the long-term impacts of higher crime, community instability, and mental health problems associated with increasing unemployment begin to spread.

The erosion of the unemployment insurance system has served to undermine its role as an automatic economic stabilizer and thereby has contributed both to the depth and duration of recession and to the accompanying rash of business bankruptcies, especially of smaller businesses that are directly dependent on consumer spending. Business failures in 1982 reached the highest level since 1932, and remain at extremely high levels. The sharp cutbacks in unemployment benefits, along with cutbacks in public assistance and employment programs, have exacerbated the impact of deteriorating economic conditions by weakening the automatic stabilizing role of the program.

In summary, it is essential for the Congress to rescind the changes imposed in 1981. Moreover, the Federal Supplemental Benefit program must not be allowed to expire at the end of the current fiscal year. Legislation to fully restore the Extended Benefit program and to preserve the potential duration available under the FSB program would parallel similar programs enacted in prior recessions.

The UAW advocates a permanent program to provide a maximum benefit duration of 52 weeks under normal circumstances and no less than 65 weeks when the unemployment rate at the national level exceeds the 4 percent goal set forth in the Full Employment and Balanced Growth Act of 1978.

The UAW appreciates this opportunity to share with this Subcommittee our views and our suggestions for reinvigorating a network of programs we believe vital for protecting workers and their communities against the debilitating effects of long-term unemployment.

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Appendix: Unemployment Benefits in High Unemployment States

	Total Unemployment Rate (May 1983)	Insured Unemployment Rate (July 9, 1983)	Status of Extended Benefits-Ending Date	Weeks of Federal Compensation Benefits (July 9, 1983)
Alabama	12.9	4.38	6/4/83	10
Alaska	10.7	6.10	On *	14
Arizona	10.1	3.23	10/23/82	8
California	9.9	4.75	7/2/83	10
Idaho	11.8	4.96	7/2/83	10
Illinois	11.8	5.09	6/25/83	8
Indiana	10.2	3.62	4/30/83	8
Louisiana	12.5	5.61	On	12
Michigan	14.7	4.43	6/11/83	10
Mississippi	11.9	5.22	7/16/83	12
New Mexico	10.3	4.17	11/27/82	10
Ohio	12.9	4.15	5/14/83	10
Oregon	10.2	5.39	7/2/83	12
Pennsylvania	12.1	6.06	On *	14
South Carolina	10.1	3.44	3/19/83	8
Tennessee	11.3	3.58	9/25/82	8
Washington	11.1	5.42	7/2/83	12
West Virginia	18.2	7.84	On	14
Wisconsin	10.2	4.25	6/18/83	10
Wyoming	10.1	5.58	On *	12

* Will end August 6, 1983.

Note: National Civilian Unemployment Rate
— seasonally adjusted: May, 10.1%; June, 10.0%.
— not seasonally adjusted: May, 9.8%; June, 10.2%.

STATEMENT OF THE
INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA
TO THE SUBCOMMITTEE
ON TAXATION AND DEBT MANAGEMENT
OF THE
SENATE COMMITTEE ON FINANCE

The Independent Petroleum Association of America is a national organization of some 7,000 independent oil and natural gas producers in every producing area of the United States. IPAA, together with the twenty-nine unaffiliated associations listed on the cover page, represent virtually all independent producers and thousands of royalty owners in the United States. We are grateful for this opportunity to present our views in support of S. 1549 to update the definition of unrelated business taxable income in connection with the hearings held by this subcommittee on August 1, 1983. We respectfully request that this statement be made a part of the permanent record of that hearing.

In general, the statutes now provide that a tax exempt organization is subject to tax at the regular corporate rates on income derived from the active conduct of a trade or business which is not substantially related to the function or purpose upon which the tax exemption is based. These provisions were adopted principally to eliminate a competitive advantage a tax exempt organization would have compared to a taxable entity engaged in the same business. The statutes distinguish income derived from a "trade or business," which is taxable and income derived from investments, which is not taxable. Therefore, income received from interest, dividends, rents or royalties do not affect the tax of the organization except in special situations. In order for the unrelated business tax to be imposed, the exempt organization must be regularly engaged in unrelated activities which constitute a trade or business such as the offering of goods for sale or the performance of services. Where an exempt organization is a member of a partnership, the law currently provides that the partner will receive unrelated business income equal to its share of the income derived from any unrelated business activity conducted by the partnership.

Interests in oil and gas properties may be held by an exempt organization in two general forms. The entity may acquire a "nonoperating interest," that is, a right to the reserves in place which is not required to bear a proportionate share of the costs of exploration, development or production. These nonoperating interests commonly take the form of royalties, net profit interests or, in limited circumstances, a production payment. The income derived from these interests is not "trade or business" income and is therefore not subject to the unrelated business tax. Oil and gas reserves may also be acquired through an "operating interest," or an interest which shares in the costs of exploration, development and production. These interests are commonly referred to as working interests and unlike a royalty or similar interest, the participation in costs of development and production place the owner in a "trade or business." This determination is not affected by the nature of the activity actually performed by the interest owner. The working interest owner is engaged in a "trade or business" even where the day to day operation of the property is delegated to a third party operator. Thus it is the nature of the interest in the property and not the activities with respect to the property which determines the existence of a "trade or business."

The bill currently before the subcommittee, S. 1549, would amend the definition of unrelated business taxable income to exclude working interests held through certain limited partnerships for pension trusts and educational organizations. These provisions would provide needed flexibility to the investment managers of pension funds and endowments by enabling them to diversify their portfolios. The bill would also make available a new source of funds to the oil and gas industry which is chronically short of investment capital. Provisions which achieve such desirable policy goals in a manner which is essentially revenue neutral, should not be rejected unless the negative potential is both clear and persuasive. The arguments presented against the provisions appear to be neither.

The principal argument against S. 1549 is that it is inconsistent with the theory of the unrelated business tax and that creating an exemption for certain oil and gas limited partnerships will lead to similar treatment for all business activity conducted by limited partnerships. These arguments are clearly strained. The "theory" of the unrelated business tax is to prevent exempt entities from using their exempt status to gain a competitive advantage. An exempt organization which holds a limited partnership interest in a partnership holding working interests has no greater or lesser competitive advantage than if it held the same interest in the form of a royalty. In both situations, the essential source of income is the sale of the production and this function is not affected by the nature of the economic interest held by the exempt entity. The provisions of S. 1549 simply allow exempt entities to acquire ownership of oil and gas reserves in a direct, straightforward manner without placing unwarranted emphasis on the legal nature of the economic interest acquired.

Concerns that the treatment of oil and gas limited partnerships proposed in this legislation will ultimately extend to other limited partnerships do not appear valid. Although Congress has chosen to treat all limited partnership income as "passive" for individuals (the limited business interest provisions of section 55 IRC for purposes of the alternative minimum tax) concerns over the future direction of policy are not appropriate reasons to object to these provisions. In any event, the largest activity conducted through limited partnerships consists of real estate investments, an activity which generally does not produce unrelated business taxable income. It should also be noted that the presence of substantial investments in equity capital in the real estate markets from exempt institutions has not resulted in significant distortions of the market.

It is also argued that the unique risks of oil and gas investments make this investment inappropriate for institutions such as pension trusts and educational endowments. It is without question that the exploration and development of oil and gas reserves involves great risk. As a result, they are not appropriate investments for those without knowledge and experience in evaluating these investments. The provisions of S. 1549, however, do not create new opportunity for exempt entities to expose themselves to risk; the provisions of the bill simply add flexibility to those investments. Exempt organizations, guided by prudent investment advice, can and do now make investments in oil and gas either through royalty interest or through the ownership of stock in producing companies. Depending upon the stage of development, the risk in these investments is just as great as in acquiring a working interest. We would not, however, seek to preclude these investments because of risk, but only require that they be guided by the standards of prudent judgement.

It has also been stated in opposition to the bill that there are not sufficient limitations on partnership allocations to prevent the transfer of tax benefits from tax exempt partners to taxable partners. When viewed in context of the existing statutory and regulatory framework, we believe these concerns are overstated. The provisions of the bill when combined with the provisions of section 704, regarding substantial economic effect in partnership allocations, and section 613A, determining basis for depletion provide a solid basis for denying tax benefits in cases of perceived abuse. To determine the potential for abuse, the entire structure of the Internal Revenue Code must be considered, not just this isolated amendment.

In summary, we believe that S. 1549 provides flexibility to institutions and capital to the oil and gas industry with little or no cost to the Treasury. The benefits to be derived from these provisions by both the institutions and the oil and gas industry are obvious, while opposition to the provisions is strained and highly subjective. The provisions of S. 1549 represent a well balanced approach to allow institutions to directly acquire interests which they can now acquire only indirectly. The provisions of the bill are a straightforward attempt to update the definition of unrelated business taxable income to reflect current business realities and should be enacted.

Independent Petroleum Association of America
August, 1983

TESTIMONY ON VOLUNTEER MILEAGE BILL

Submitted by Mamie Hamilton Lee, President,

National Association of Meal Programs

I am Mamie Lee, President of the National Association of Meal Programs. This is the national association of community meals on wheels and of many congregate meals programs. We presently have 366 members, and anticipate this number to double in the next two years. Traditionally meals on wheels programs have been independent and concerned only with their own community. Since the 1978 reauthorization of the Older Americans Act and the development in the ensuing five years of standards and funding for home-delivered meals, communities have found the need to become part of a national meals association.

We have taken many strides during these five years, and we are especially proud of our record in building community involvement and support in a program which could easily be turned over to Government. We believe in people helping people. But sometimes those helping people need some help themselves. That is why I am here today to testify on the Volunteer Mileage Bill.

It's not so very long ago that the myth of the rich lady volunteer was believed by most of us. It took the development of such programs as Meals on Wheels to help us all begin to recognize who the volunteers really are - you, me, our neighbors, friends, colleagues, parents, grandparents, children. Everyone of us needs to give; every one of needs to be needed. And the wonderful part is, we are all needed.

The industrialization and massive technological change of the past few decades have taken our society and kind of turned it upside down. Where there used to be a relative around, or a neighbor, or a church nearby which made certain an isolated older person was cared for, had food, had someone to talk to, there today often is no one who even knows that older person is there. And if they know, they may well be fearful "of becoming involved," of trying to help and then ending up with more responsibility than they can manage.

So we suddenly have said that Government should begin providing for all the isolated, lonely, ill, hungry people in our country. Yet Government is limited by the money which we give in the form of taxes. And, if Government did do everything, what use would there be for us, the ordinary citizen who wants to be a part, who wants to live in a way that brings meaning and satisfaction - which comes only in being able to give of oneself to others?

We also know, though, that most giving involves costs of some kind. A cost that has increased geometrically over the past five years is the cost of travel. And for the meals on wheels volunteer, this isn't just travel to a place where one can volunteer, it may mean traveling to pick up meals, driving a route of ten to twenty miles to deliver the meal, and then returning to the pick-up site to deposit the carriers.

The people who have the time during the day to deliver these meals to isolated, homebound, mainly elderly persons, are usually themselves older, and retired. This means they are living on a fixed income. Today an ever increasing number of people who have been working are either working less, or are unemployed. They, too, have time and skills to offer, and they have an even greater need than before to be able to help others, to feel productive.

What we need is a partnership between the Government and the people to make volunteering of one's time, skills, energy possible, and this without the taint of the Government involvement which all too often destroys the community spirit to look after their own. One way to help the volunteer is to allow deduction of travel or mileage costs for federal income tax purposes.

For Government and for business when an employee uses their own personal car for Government or business tasks, they are reimbursed at a rate around twenty-two cents per mile. Present tax law provides for a deduction of 20 cents a mile when the car is used for business and nine cents a mile for a volunteer. We simply have not kept up with the ever increasing costs of gasoline and car maintenance. Certainly with all the financial data available it would be possible to link the amount of deduction allowed to a realistic travel or mileage cost indicator, and at minimum to allow the same amount for the volunteer as for the person conducting "business."

This is all we ask - that the individual volunteer have the opportunity to deduct travel/mileage costs at the same going rate as used by Government and business for their employees, and at a minimum, that the rate applied to business in the tax laws also apply to volunteers.

What we have not touched upon is those volunteers who do not have enough non-Social Security Security income to necessitate completing the "long" tax form, do not itemize their deductions. Most of these volunteers are over age 65; some are in their eighties. As soon as the price of gasoline doubled a few years ago, we found these volunteers confronted by an extremely difficult problem: how to find the money to pay the costs to deliver those meals. They give freely of their time, their skills, their caring. What many do not have is the money to buy gas.

Although this problem is not considered in this Bill, we want to raise it for your future consideration. One option we would suggest is giving these volunteers a tax credit on their gasoline - i.e. give them a ration card, or a sort of credit card, to buy gasoline tax free. This would make possible a sharing by Government and the volunteers in the cost of the gasoline, and a greater sharing in the caring for human need.

If such a program would be too cumbersome to administer, perhaps a system similar to that used for public vehicles could be extended to volunteers. Again, the partnership would help make it possible for the volunteer to carry out his or her duties.

Looking at this same partnership from the service perspective we can quickly see that the meals on wheels volunteers while helping people in need are also relieving the Government of what could be a costly and never-ending burden. Without proper nutrition many more people would be requiring crisis medical care, and would have to be institutionalized. According to the recent Administration on Aging meal program evaluation report (Kirschner Associates of Albuquerque and Opinion Research Corporation of Princeton, New Jersey), the average home-delivered meals recipient is 78 years old and in poor health; 65% have imcomes under $6,000; 98% of those receiving home-delivered meals are "priority"

- i.e. are frail, low income, minority, and/or over age 75. Without meals on wheels many more would be in institutions supported by Medicaid and Medicare.

Since a key benefit to the volunteer is the sense of being needed and knowing that someone's well-being depends on the delivery of those meals, meals on wheels benefits the well elderly as well as the more infirm elderly. The tax deduction for mileage at a rate equal to that for business would be a recognition of the valuable contributions made by volunteers, and especially those elderly volunteers who are the backbone of both the meals on wheels and congregate meals programs. This deduction would also provide that extra financial assistance needed by many to make being a volunteer possible.

NIET The NATIONAL INSTITUTE
For ENTREPRENEURIAL TECHNOLOGY

Philip Speser, J.D., Ph.D.
Executive Director

STIMULATING PRIVATE SECTOR INVESTMENTS IN OUR FUTURE

Testimony on S. 108 submitted to
the Senate Subcommittee on Taxation and Debt Management

Philip Speser, J.D., Ph.D., Executive Director
National Institute for Entrepreneurial Technology

As America shifts from an industrial-based to a high-technology-based economy. new skills are required for careers. Those who lack these skills will have increasing difficulties in finding employment. The impacts of these changes are seen in widespread unemployment due to cutbacks in basic industries such as automobiles and steel. S. 108 provides important tax incentives which will benefit displaced workers and youth seeking to enter the job market.

The ability of high-technology firms to contribute to economic development through product and process innovation and its associated benefits. depends upon the presence of highly skilled, highly educated technicians and paraprofessionals. (Brown and Hekman, *New England Economic Review*. Ja/Feb, 1980; Hekman and Strong, *New England Economic Review*. Mar/Ap, 1981; Rothwell, *Omega*, vol. 9(3), 1981. *Problems of Small High-Technology Firms*, NSF 81-305.) Yet. small firms as well as large firms are increasingly confronting labor shortages. (American Electronics Association. *Technical Employment Projections*, May 1981; Secretary of Education and Director of National Science Foundation. *Report to the President: Science and Engineering Education for the 1980's and Beyond*, October, 1980; U.S. Bureau of Labor Statistics, *Monthly Labor Review*. August, 1981.) The Bureau of Labor Statistics has projected a 40% increase in employment opportunities in science and engineering occupations at all degree levels from 1978 to 1990. (National Science Foundation. *Five-Year Outlook*, p.7).

In light of the fact that small high-technology firms are one of the primary sources for net new job generation in the United States (Birch, The Job Generation Process, 1979; Location of High Technology Firms and Regional Economic Development, Staff of Joint Economic Committee, June 1, 1982.), it is important to ensure that their growth is not stymied by the absence of an appropriate labor force. "Yet," Pat Hill, Manager of Technology Training and Careers for the American Electronics Association, testified, "they are affected by the technical manpower shortages to a greater extent than their larger industry counterparts simply because, unlike them, small companies cannot conduct extensive in-house training programs to 'grow' their own technical talents." (Before the Senate Small Business Committee, Feb. 18, 1981.)

Community colleges and technical institutes can play a vital role in preparing students for careers in high-technology industries. They are already important sources for supplementing and/or replacing on-the-job training for technicians and for educating and training technicians who later become engineers by directly going on to an engineering school or as a result of on-the-job training (Dept. of Ed./NSF Staff Analysis, October, 1980, p. 42). Post-secondary vocational education can play a role in aiding business and industries to maintain or regain their technological leadership and improve productivity.

Yet these schools face a number of problems in providing education and training for students interested in high-technology careers. As the National Science Foundation's second Five-Year Outlook on Science and Technology (NSF 81-40) notes, for example, community colleges are not yet integrated into the rest of the science and engineering education system. The NSF highlights problems in upgrading faculty, curricula, and equipment.

Business-community college/technical institute relationships are an important means for addressing these problems (National Center for Research in Vocational Education, Preparing for High Technology, 3 vols., 1982). With business assistance, community colleges have developed projects in areas such as computer graphics, mini-computers, medical electronics, robotics, records management and word processing, precision optics, and laser optics (Preparing for High Technology, Programs That Work.)

Yet funding for such important programs is difficult to obtain. S. 108 would provide crucial Federal tax incentives thereby enabling community colleges and technical institutions to leverage private sector investments. S. 108 is needed because current tax provisions in effect skew business investment decision-making by offering greater incentives for establishing programs with universities and four-year colleges than with other degree-granting post-secondary institutions.

We do, however, feel that S. 108 does not go far enough. If enacted, this legislation is likely to have a far greater impact on corporate equipment donation strategies than on corporate provision of instructors or hiring of part-time employees. The tax incentives for the latter activities are most likely too minor to do more than reward taxpayers already included to engaged in what is, admittedly, a worthwhile pursuit.

Rather than providing greater incentives for instructors and hiring, we would urge the Committee to focus directly on the financial needs of community colleges and technical institutes offering important education and training programs. Tax incentives also are needed to encourage employers to provide tuition payments for community college and technical institute degree-granting programs.

Such incentives are particularly important for small high-tech companies. Even though these firms are the primary source of net new high-tech job generation, they lack the disposible income which larger firms use for in-house training programs and grants to educational institutions.

We urge that S. 108 be amended to include a tax credit for small firms which participate in cooperative education programs for paraprofessionals and technicians with accredited degree-granting post-secondary institutions. In order to qualify for the credit, the firm would be required to release the employee for at least 10% of his(her) time to participate in a education and training program. Such programs would be designed by the cooperating schools, unions. and firms. The only other requirements would be that the program must involve both in-house apprenticeship and classroom education components, and that successful completion of the program would result in at least an Associates Degree for the student. For every employee enrolled in the program, the firm would qualify for a tax credit equal to all sums that it contributed to the school for the operation of the program plus the employee's release time wages or salary for the period that the employee is enrolled in the program if the employee was hired within the last 12 months. A cap of 5% of the employee's annual wage or salary would be placed upon the credit.

We urge the Committee to endorse S. 108 and to enhance its operation by adopting our suggested amendment. If needed, tax incentives for corporate provision of instructors and hiring instructors as part-time employees could be deleted from the bill. I want to emphasize, however, that even if no changes are made, we support this legislation. As we stated when we endorsed this legislation in a recent issue of our newsletter, NIETNET, "The shortage of highly-trained, highly-educated people for high-tech industries demands a new emphasis on quality Associates Degree programs as well as attention to B.A., B.S., M.A., and Ph.D. programs."

TAAA
Travelers Aid Association of America
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Executive Director, Joel E. Rus

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August 12, 1983

Hon. William Armstrong
Senate Subcommittee on
Taxation and Debt Management
215 Dirksen Senate Office Building
Washington, DC 20510

RE: Testimony for Hearings on Volunteer Mileage Deduction Legislation,
S1167 and S1579

Dear Seantor Armstrong:

Every year over 2.6 million people find that Travelers Aid gives an immediate helpful response to their problems. In transportation terminals and in center city offices, Travelers Aid provides assistance that is not available through government programs or commercial enterprises. From runaway youths to elderly vacationers, from unemployed jobseekers to business travelers, Travelers Aid provides unique counseling and emergency assistance resources for individuals and families who experience a problem or a crisis while separated from home and familar forms of support.

The cornerstone of Travelers Aid is the 4,000 direct service volunteers and board trustees who freely incorporate to form nonprofit social agencies. Together they have established services that provide cost saving, remedial assistance to America's highly mobile population. Last year, Travelers Aid volunteers donated 750,000 hours of labor to improve the welfare of Americans and to make their communities better places to be.

In pursuit of their voluntary activities they also logged countless thousands of miles in their vehicles to reach their assignments and to attend organizational meetings. The cost of these activities are born by the volunteers. The benefits extend to service recipients, agencies at all levels of government, commercial organizations and our urban communities.

A United Way Agency

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2.6 million people assisted by 4,000 volunteers donating 750,000 hours of labor. This is a form of American enterprise that should be encouraged through changes in public policy. Because volunteers are essential to our efforts to help mobile and displaced Americans, Travelers Aid Association of America strongly supports S1167 sponsored by Senator Durenberger of Minnesota and S1579 sponsored by Senator Armstrong of Colorado. These bills would revise the Internal Revenue Code to give the same mileage deductions to persons donating their time to volunteer enterprises as is given for commercial activity or government service.

It is our view that the proposed revisions to the Internal Revenue Code will further encourage the contributions being made by volunteers to Travelers Aid and the related charitable organizations with whom we work on behalf of the American people.

We urge the Senate Finance Committee and the United States Senate to support S1167 and S1579 which will strengthen the voluntary sector and a key pillar of the American way of life.

Sincerely,

Joel E Rus

Joel E. Rus
National Executive Director

JER/jms

YMCA of the USA
Washington Office
1725 K Street NW
Suite 408
Washington, DC 20006

[illegible]

August 2, 1983

The Honorable Bob Packwood
Chairman, Subcommittee on Taxation
and Debt Management
Senate Committee on Finance
SD-219 Dirksen Senate Office Building
Washington, DC 20510

Dear Senator Packwood:

We urge the support of the Subcommittee on Taxation and Debt Management for legislation to raise the deduction for charitable use of an automobile to the level of reimbursement for business or government use. The National Board of YMCAs has unanimously voted its approval of such legislation.

Both the public and private for-profit sectors are placing greater emphasis on voluntarism as one means of responding to social needs; organizations such as the YMCA of the USA have long devoted themselves to fostering such volunteer efforts. Dedicated volunteers not only give freely of themselves but often must either absorb some of the expenses incurred in their service or curtail their voluntary activities. In relation to the use of automobiles, volunteer service is surely as valuable to society as that intended for purposes of public government or private profit.

We would appreciate your incorporating this letter into the record of the Subcommittee's hearing of yesterday on this and other tax measures.

Sincerely,

Patty Bankson

Patty Bankson
Director, Washington Office

PB/skm

Eve Hall
President, National Council
Dale Vonderau
Chairman, National Board
Solon B. Cousins
Executive Director